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**VIA HAND DELIVERY**

Ms. Cynthia Brown  
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395 E Street, S.W.  
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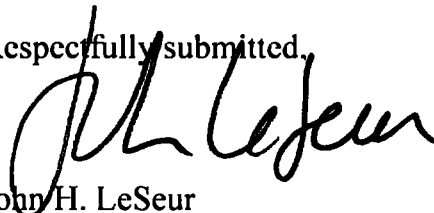
Re: STB Finance Docket No. 35506, *Western Coal Traffic League –  
Petition for a Declaratory Order*

Dear Ms. Brown:

Enclosed for filing in the above-referenced proceeding, please find an original and ten (10) copies of the Joint Opening Evidence and Argument of the Western Coal Traffic League, American Public Power Association, Edison Electric Institute, National Association of Regulatory Utility Commissioners, National Rural Electric Cooperative Association, Western Fuels Association, Inc., and Basin Electric Power Cooperative, Inc. This filing includes three copies of a CD containing the text of the Opening Evidence and Argument, as well as three copies of a CD, marked **Highly Confidential**, containing the electronic workpapers in support of the Verified Statement of Messrs. Crowley and Fapp.

Please date stamp the extra copy of this cover letter and the enclosed duplicate filing and return it to our messenger. Thank you for your attention to this matter.

Respectfully submitted,



John H. LeSeur  
An Attorney for the Listed Parties

cc: Service List  
Enclosures

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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WESTERN COAL TRAFFIC  
LEAGUE – PETITION FOR  
DECLARATORY ORDER

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Finance Docket No. 35506

**JOINT OPENING EVIDENCE AND ARGUMENT OF  
THE WESTERN COAL TRAFFIC LEAGUE  
AMERICAN PUBLIC POWER ASSOCIATION  
EDISON ELECTRIC INSTITUTE  
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS  
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION  
WESTERN FUELS ASSOCIATION, INC.,  
AND  
BASIN ELECTRIC POWER COOPERATIVE, INC.**

**OF COUNSEL:**

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Dated: October 28, 2011

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**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

WESTERN COAL TRAFFIC	)	
LEAGUE – PETITION FOR	)	
DECLARATORY ORDER	)	Finance Docket No. 35506
	)	

**JOINT OPENING EVIDENCE AND ARGUMENT OF  
THE WESTERN COAL TRAFFIC LEAGUE, AMERICAN PUBLIC POWER  
ASSOCIATION, EDISON ELECTRIC INSTITUTE, NATIONAL ASSOCIATION  
OF REGULATORY UTILITY COMMISSIONERS, NATIONAL RURAL  
ELECTRIC COOPERATIVE ASSOCIATION, WESTERN FUELS  
ASSOCIATION, INC., AND BASIN ELECTRIC POWER COOPERATIVE, INC.**

The Western Coal Traffic League (“WCTL”), American Public Power Association (“APPA”), Edison Electric Institute (“EEI”), National Association of Regulatory Utility Commissioners (“NARUC”), National Rural Electric Cooperative Association (“NRECA”), Western Fuels Association, Inc. (“WFA”), and Basin Electric Power Cooperative, Inc. (“Basin Electric”) (collectively “Coal Shippers/NARUC”) present their Joint Opening Evidence and Argument.

**PREFACE AND SUMMARY**

This case raises a fundamental regulatory question: whether shippers that are captive to BNSF Railway Company (“BNSF”) should pay higher rail rates simply because BNSF’s ownership has changed hands. Where BNSF-captive shippers are regulated electric utility coal shippers, there is a basic subsidiary question: whether electric utility consumers should have to pay higher electric utility bills simply because

one of the world's richest men decided to purchase a railroad. Coal Shippers/NARUC submit the answer to both questions is a resounding "NO!"

Berkshire Hathaway Inc. ("Berkshire") is a large holding company. Its primary shareholder, chairman and chief executive officer is Warren Buffett. Mr. Buffett is a legendarily astute investor and, as a direct result of his business acumen, is one of the world's richest men. In 2010, Mr. Buffet negotiated a deal that led to Berkshire's purchase of BNSF for a total price of approximately \$43 billion. Since that time, Mr. Buffet has touted the high returns Berkshire is earning on its investment in BNSF.

Coal Shippers/NARUC commend Mr. Buffett on making a good deal for himself and other Berkshire shareholders. We simply ask that this good fortune for the new owners of BNSF does not directly translate into misfortune for captive BNSF customers in the form of rates that are increased solely because the ownership of BNSF changed hands.

When it acquired BNSF, Berkshire paid a substantial premium over the railroad's pre-acquisition book value, which for Surface Transportation Board ("STB") regulatory costing purposes approximates \$8,100,000,000.<sup>1</sup> Under the current regulatory daisy chain, this \$8,100,000,000 premium is included in BNSF's STB regulatory accounts, which are then fed into BNSF's Annual R-1 report, which, unless the Board

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<sup>1</sup> As discussed below, WCTL initially calculated the premium as equaling \$7,625,000,000. However, based on new information supplied by BNSF after this calculation was made, the \$7,625,000,000 figure has been revised upward to \$8,100,000,000.

declares otherwise, will be used by the Board's staff to create BNSF's 2010 Uniform Railroad Costing System ("URCS") data set, which will then generate premium-infused, increased variable costs, which will then be used to determine the Board's regulatory jurisdiction, as well as a captive shipper's maximum rates.

Under current law, the Board has no jurisdiction over BNSF rates that are less than 180% of BNSF's variable costs and, under current Board regulations, the Board sets maximum rates at the greater of (i) 180% of BNSF's variable costs or (ii) a maximum rate expressed as a revenue-to-variable cost ("R/VC") ratio. The bottom line is that any use of premium-infused variable costs automatically raises the rate levels that trigger the Board's regulatory jurisdiction, and automatically increases the maximum rates the Board can prescribe for captive shippers that remain subject to its jurisdiction.

It is fundamentally unfair for captive shipper rates to increase – automatically – simply because Berkshire paid an acquisition premium to acquire BNSF. This unfairness is magnified for captive utility coal shippers. As this Board has repeatedly recognized, increases in captive utility shippers' coal transportation rates ultimately are paid by electric consumers as part of their monthly electric bills. Captive shippers, and their customers, should not have to pay more simply because Berkshire paid a premium to purchase BNSF.

This fundamental unfairness is universally acknowledged. No state or federal regulator permits the pass-through of acquisition premiums to consumers in similar forms of transactions. Similarly, Members of Congress who have weighed-in on

this issue have uniformly condemned the pass-through of the Berkshire premium to captive shippers, as has the U.S. Department of Agriculture ("USDA").

BNSF defends the premium. It argues that "precedent" and Generally Accepted Accounting Principles ("GAAP") require the automatic pass-through of premium-generated rate increases to its captive customers. Neither contention is correct. Berkshire's acquisition of BNSF is materially different than past mergers that have come before the Board. The Board has approved prior rail mergers involving premiums on grounds that the mergers would inure to the shipping public's benefit in the form of reduced costs and rates (brought about by merger synergies). Unlike these transactions, Berkshire's acquisition of BNSF brings about only premium-generated increased regulatory costs and increased rates for captive shippers.

Nor does GAAP or any other accounting rule govern here. The Board is charged with setting maximum reasonable rates and the Board's current maximum rate standards rely on costs in setting those rates. Costs used to develop maximum rates must be calculated in a manner consistent with the overriding Congressional intent that the Board exercise sound judgment and protect the public interest. As long recognized by the courts, "it is rates, not bookkeeping that [the Interstate Commerce Act] requires to be reasonable, and there is no assurance . . . that reasonable accounting measures translate automatically into reasonable rates." *Farmers Union Cent. Exch. v. FERC*, 584 F.2d 408, 418 (D.C. Cir. 1978) ("*Farmers Union I*").

The STB clearly has the authority to protect the public interest in this case by exercising its statutory authority to adjust BNSF's URCS variable costs to remove the acquisition premium for purposes of determining and applying its maximum rate jurisdiction over captive rail traffic. This action will ensure that captive BNSF customers' rates will not be higher simply because Mr. Buffet decided that Berkshire should acquire BNSF and pay an acquisition premium to do so. Also, removal of the premium is not unfair to BNSF or its shareholders. They can continue to earn handsome rewards from Mr. Buffet's investment. It simply prevents unfairly gouging shippers who have no choice but to utilize BNSF's services.

In this opening submission, Coal Shippers/NARUC present the argument of Counsel in support of their request that the Board removal of the acquisition premium from BNSF's 2010 URCS, along with verified statements ("V.S.") by: Charles D. Gray, Executive Director of NARUC; Dr. John W. Wilson, President of Wilson & Associates; Dr. Robert E. Verrecchia, the Elizabeth F. Putzel Professor of Accounting at the Wharton School of the University of Pennsylvania; and a joint statement from Thomas D. Crowley, President of L.E. Peabody & Associates, Inc. ("LEPA") and Daniel L. Fapp, Vice President of LEPA. Coal Shippers/NARUC also request that the Board remove the premium from the investment base the Board utilizes to calculate BNSF's revenue adequacy.

## **IDENTITY AND INTEREST**

WCTL is a voluntary association, whose membership is comprised exclusively of organizations that purchase and ship coal from origins west of the Mississippi River. WCTL members collectively consume more than 170 million tons of coal annually that is moved by rail. Its members include investor-owned electric utilities, electric cooperatives, state power authorities, municipalities, and a non-profit fuel supply cooperative.<sup>2</sup>

APPA is the national service organization representing the interests of over 2,000 municipal and other state- and locally-owned electric utilities in 49 states (all but Hawaii). Collectively, public power utilities deliver electricity to one of every seven electric consumers (approximately 46 million people), serving some of the nation's largest cities, but also many of its smallest towns. Over 40% of public power utilities generate power from coal.

EEL is the association of U.S. shareholder-owned electric utility companies. EEL's members serve 95 percent of the ultimate customers in the shareholder-owned segment of the industry, and they represent approximately 70 percent of the U.S. electric

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<sup>2</sup> WCTL's members are: Ameren Energy Fuels & Services, Arizona Electric Power Cooperative, Inc., CLECO Corporation, Austin Energy (City of Austin, Texas), CPS Energy, Entergy Services, Inc., Kansas City Power & Light Company, Lower Colorado River Authority, MidAmerican Energy Company, Minnesota Power, Nebraska Public Power District, Omaha Public Power District, Texas Municipal Power Agency, Western Farmers Electric Cooperative, Western Fuels Association, Inc., Wisconsin Public Service Corporation, and Xcel Energy.

power industry. EEI's diverse membership includes utilities operating in all regions, including in regions with Regional Transmission Organizations and Independent System Operators, and companies supplying electricity at wholesale in all regions.

NARUC is the national organization of State commissions responsible for economic and safety regulation of utilities. NARUC members in the fifty States, the District of Columbia, Puerto Rico, and the Virgin Islands have the obligation under State law to ensure the establishment and maintenance of such energy utility services as may be required by the public convenience and necessity, as well as ensuring such services are provided at just and reasonable rates. NARUC is consistently recognized by Congress, the Courts, and a host of federal agencies (including the Federal Energy Regulatory Commission), as the proper entity to represent the collective interests of State utility commissions.

NRECA is the national service organization for more than 900 not-for-profit rural electric utilities that provide electric energy to approximately 42 million consumers in 47 states or 13 percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all electric energy sold in the United States. NRECA members generate approximately 50 percent of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members. The vast majority of NRECA members are not-for profit, consumer-owned cooperatives. NRECA's members also include approximately 65 generation and transmission ("G&T") cooperatives, which generate and transmit power to 668 of the 841

distribution cooperatives. The G&Ts are owned by the distribution cooperatives they serve. Remaining distribution cooperatives receive power directly from other generation sources within the electric utility sector. Both distribution and G&T cooperatives were formed to provide reliable electric service to their owner-members at the lowest reasonable cost.

WFA is a non-profit fuel supply cooperative corporation headquartered in Denver, Colorado. WFA's members consist of consumer-owned utilities, including rural electric G&T cooperatives, municipal utilities and other public bodies. WFA exists to assist its members in obtaining coal, and coal transportation.

Basin Electric is a non-profit, regional consumer-owned wholesale electric G&T cooperative, headquartered in Bismarck, North Dakota. Basin Electric generates and transmits electricity to 120 member rural electric systems in nine states. These systems in turn distribute electricity to 1.8 million people. Basin Electric's mission is to provide cost-effective wholesale energy and related services to its members.

Coal Shippers/NARUC believe that it is fundamentally unfair for captive shipper rates to increase – automatically – simply because Berkshire paid a premium to acquire BNSF. Accordingly, Coal Shippers/NARUC have a strong interest in this proceeding.



## BACKGROUND

### A. Berkshire's Acquisition of BNSF

On February 12, 2010, Berkshire acquired BNSF for a total purchase price of \$42.919 billion. This price consisted of cash and stock consideration of \$34.495 billion and \$8.424 billion of assumed debt and liabilities:

<b>Total Consideration Paid By Berkshire Hathaway For BNSF</b>		
(in millions)		
1.	Cash Paid as Merger Consideration	\$15,874
	Value of Berkshire Common Stock Issued as Merger	
2.	Consideration	\$10,577
3.	Value of BNSF Stock Already Owned by Berkshire	\$7,678
4.	Other Consideration	<u>\$366</u>
5.	Total Value of Money and Stock Consideration	\$34,495
6.	Value of Debt and Liabilities Assumed By Berkshire	<u>\$8,424</u>
7.	<b>Total Purchase Price</b>	<b>\$42,919</b>
Source for lines 1-4, and 6, Burlington Northern Santa Fe LLC 1Q 2010 10-Q, Page 9 and BNSF Railway 1Q 2010 10-Q, Page 9		
Line 5= L1 + L2 + L3 + L4		
Line 7= L5 + L6		

See V.S. Crowley/Fapp at 4-5.

With its purchase, Berkshire acquired all of the outstanding shares of BNSF's parent, Burlington Northern Santa Fe Corporation, which, following other corporate maneuvers, was renamed Burlington Northern Santa Fe, LLC. BNSF is now a wholly owned subsidiary of Burlington Northern Santa Fe, LLC. See BNSF Ann. Rep. R-1 at 9 (2010).

Berkshire's acquisition has proven to be very remunerative for Berkshire's shareholders, including Berkshire's primary shareholder, chairman and chief executive

officer, Mr. Warren Buffet. As Mr. Buffet explained in his letter to Berkshire shareholders:

The highlight of 2010 was our acquisition of Burlington Northern Santa Fe, a purchase that's working out even better than I expected. It now appears that owning the railroad will increase Berkshire's "normal" earning power by nearly 40% pre-tax and by well over 30% after-tax. Making this purchase increased our share count by 6% and used \$22 billion of cash. Since we've quickly replenished the cash, the economics of this transaction have turned out very well.

Berkshire Hathaway Inc., 2010 Chairman's Letter to Shareholders (Feb. 26, 2011)  
(Berkshire 2010 Annual Report at 3).

These very good returns are not the product of any changes Berkshire made in the management and operations of BNSF. Mr. Buffet simply followed his established practice of buying very profitable companies, and letting the company's executives continue to manage the day-to-day operations of the acquired company. As Matt Rose, BNSF's CEO succinctly put it: "[o]utside of no longer having a board of directors and no longer having a publicly traded company . . . the operation itself has not seen any difference whatsoever." The Wall Street Transcripts, Feb. 22, 2011 *available at* <http://www.twst.com/yagoo/als609MATTH REW1.html>.

## **B. Acquisition Accounting**

Berkshire used the acquisition method to account for its purchase of BNSF in its filings with the Securities and Exchange Commission. BNSF followed suit in its post-acquisition regulatory accounting and reporting with the STB. As explained by BNSF, "[u]nder the acquisition method, the basis of accounting totaling \$42,919 million

was pushed down and allocated to the underlying tangible and intangible assets acquired and liabilities assumed based on their respective fair values, with the remainder of \$14,803 million allocated to goodwill (included in other assets).” BNSF Ann. Rep. R-1 at 9 (2010).

Application of this method produced a post-acquisition book value for BNSF equal to \$64.983 billion:

<b>BNSF’s R-1 2010, Schedule 200 – Comparative Statement of Financial Position</b>			
<b>Assets</b>		<b>Liabilities and net assets acquired</b>	
Cash	\$ 14	Accounts payable, Taxes accrued and Other current liabilities	\$ 2,197
Accounts receivable	829	Equipment obligations and other long-term debt due within one year	342
Materials and supplies	629	Long-term debt	2,326
Working fund prepayments			
deferred income tax debits	202	Accumulated deferred income tax credits	13,696
Other current assets	272	Other long-term liabilities and deferred credits	4,341
Property and equipment	45,666	Retained Earnings	42,919
Other assets	16,735	Intercompany note receivable	(838)
Other deferred debits	636	Unappropriated Retained Earnings	42,081
<b>Total assets</b>	<b>\$ 64,983</b>	<b>Total liabilities and net assets acquired</b>	<b>\$ 64,983</b>

See V.S. Crowley/Fapp at 3-5.

### **C. The Acquisition Premium**

The Board has defined an acquisition premium as “the difference between the book value and the purchase price of [acquired] properties.” *CSX Corp. – Control & Operating Leases/Agreements – Conrail Inc.*, 3 S.T.B. 196, 261 n.93 (1998) (“*Conrail*”). Using this definition, BNSF paid an acquisition premium of \$12.646 billion, which equals the difference between the net purchase price of the acquired properties (at fair market value) of \$46.584 billion minus the pre-acquisition book value of the acquired

properties of \$33.938 billion. *See* BNSF Ann. Rep. R-1 (2010) (Acquisition Premium = Sch. 330 Gross Investment – Sch. 335 Accumulated Depreciation).

However, for purposes of developing URCS variable investment costs, and for purposes of determining carrier revenue adequacy, the Board develops a current cost of capital return on a carrier's net investment base. This net investment base is calculated using the following formula: net investment base = gross investment – accumulated depreciation – working capital – deferred taxes. *See* V.S. Crowley/Fapp at 8 and Op. workpaper: "Impact of acquisition on BNSF URCS accounts.xls".

In its May 2, 2011 Petition for a Declaratory Order ("WCTL Petition"), WCTL applied this formula to the pertinent BNSF inputs as they existed before and after the Berkshire acquisition and demonstrated that, left unchecked, the Berkshire acquisition of BNSF would produce a \$7.625 billion write-up in BNSF's net investment base and would decrease BNSF's annual depreciation charges by \$49 million:

**SUMMARY OF IMPACT OF BERKSHIRE HATHAWAY  
ACQUISITION OF BNSF ON URCS ACCOUNTS AND – 2010**

<u>Item</u>	<u>Amount (in millions)</u>		
	<u>As Reported in 2010 R-1</u>	<u>Excluding Acquisition Costs</u>	<u>Difference</u>
1. Gross Investment - End of Year (Schedule 330)			
a. Road Property	\$40,832	\$36,692	\$4,140
b. Equipment	\$6,176	\$8,998	-\$2,822
c. Construction Work in Progress	\$528	\$534	-\$6
d. Total	\$47,536	\$46,224	\$1,312
2. Accumulated Depreciation - End of Year (Schedule 335)			
a. Road Property	\$534	\$8,837	-\$8,303
b. Equipment	\$508	\$3,539	-\$3,031
c. Total	\$1,042	\$12,376	-\$11,334
3. Working Capital (Schedule 245, L28)	\$663	\$663	\$0
4. Deferred Taxes (Schedule 200, L49)	\$14,528	\$9,507	\$5,021
5. Net Investment For URCS	\$32,629	\$25,004	\$7,625
6. Annual Depreciation			
a. Road Property	\$1,048	\$1,067	-\$19
b. Equipment	\$685	\$715	-\$30
c. Total	\$1,733	\$1,782	-\$49
Sources: BNSF 2010 R-1 Schedules 330, 332, 335, 412, 415, and 450			

See WCTL Petition at Attachment No. 2.

WCTL noted in its Petition that its write-up and annual depreciation calculations were based on public information available to it as of the filing date of the Petition (May 2, 2011). WCTL requested that the Board order BNSF to produce the non-publicly available “workpapers supporting BNSF’s write-up and depreciation calculations.” WCTL Petition at 9. The Board granted this request,<sup>3</sup> and BNSF provided responsive workpapers on October 4, 2011 and October 17, 2011. BNSF designated

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<sup>3</sup> See *Western Coal Traffic League – Petition for Declaratory Order – Motion for Protective Order*, Finance Docket No. 35506 (STB served Sept. 28, 2011), at 2.

these workpapers as highly confidential under the governing protective order in this proceeding.

Crowley/Fapp have reviewed BNSF's workpapers, and based on that review, they now demonstrate that, left unchecked, BNSF's net investment base will increase by \$8.1 billion, and BNSF's annual depreciation charges will decrease by \$128 million, as a result of the Berkshire acquisition. *See* V.S. Crowley/Fapp at 6.<sup>4</sup> For ease of citation, Coal Shippers/NARUC will refer to this \$8.1 billion net asset write-up figure as the "premium" or "acquisition premium."

#### **D. Potential Impact of the Acquisition Premium**

Unless the Board acts, the acquisition premium will directly impact the Board's calculation of BNSF's URCS costs, starting in 2010. The \$8.1 billion acquisition premium is recorded in BNSF's regulatory accounts, and in its 2010 Annual Report R-1, and unless the Board otherwise directs, its staff will input the \$8.1 billion premium into BNSF's 2010 URCS, as well as the increased annual depreciation charges associated with the new investment base. This result, if the Board permits it, will have very adverse impacts for captive shippers:

##### **1. Jurisdictional Threshold**

The STB possesses jurisdiction to regulate the maximum rates on common carrier rail traffic over which the defendant carrier exerts "market dominance." 49

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<sup>4</sup> Coal Shippers/NARUC cannot reproduce these calculations in the format shown above due to BNSF's designation of the changed inputs as Highly Confidential.

U.S.C. §§ 10701(d)(1), 10707(c). Congress has established a conclusive presumption that a defendant carrier lacks market dominance in cases where the carrier demonstrates that the R/VC ratio on the issue traffic “is less than 180 percent.” 49 U.S.C. § 10707(d)(1)(A).

The Board calculates variable costs for jurisdictional purposes using URCS costs. If the BNSF acquisition premium is included in BNSF’s 2010 URCS, the total variable costs will increase, as will the resulting jurisdictional threshold (variable costs x 1.80). For example, on a typical coal movement of 1,000 miles, the jurisdictional threshold will increase by \$0.58 per ton. *V.S. Crowley/Fapp* at Exh. 4, p. 1. On a typical 1200 mile grain movement, the jurisdictional threshold will increase by \$ 0.40 per ton. *Id.* at Exh. 4, p. 2.<sup>5</sup>

The increase in the jurisdictional threshold will mean fewer captive BNSF shippers will be able to invoke the Board’s regulatory jurisdiction. *Crowley/Fapp* estimate that many BNSF shippers will lose their right to seek redress at the Board if the Board includes the acquisition premium in BNSF’s URCS. *V.S. Crowley/Fapp* at 10.

## **2. Maximum Rates**

In all rail rate cases litigated since 1985 under the Board’s large rate case procedures, the Board has set maximum rates at the greater of the jurisdictional threshold or the stand-alone costs (“SAC”) for the movement. In *Major Issues*, the Board adopted

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<sup>5</sup> If the impact of the Berkshire acquisition of BNSF on the URCS industry average cost of capital is considered, the actual per ton premium generated increase for both movements is \$0.88 per ton. *See id.* Exh. 4, pp. 1-2.

a new Maximum Mark-up Methodology (“MMM”) which, as subsequently implemented by the Board, sets maximum SAC rates at prescribed R/VC ratios. *Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1) (STB served Oct. 30, 2006) (“*Major Issues*”). Thus, following *Major Issues*, both maximum rate metrics – the jurisdictional threshold and SAC, are set using R/VC ratios.

Inclusion of the acquisition premium decreases the rate relief available to shippers litigating large rate cases against BNSF. For example, in 2009, the Board prescribed maximum MMM R/VC ratios on WFA/Basin Electric’s coal traffic moving from the Power River Basin of Wyoming to the Laramie River Station, situated near Wheatland, Wyoming. The maximum MMM R/VC ratio on this traffic in 2011 is 246%. Crowley/Fapp estimate that payments under WFA/Basin Electric’s rate prescription will increase by approximately \$1.9 million annually, and by approximately \$25.2 million over the remaining life of the rate prescription, due to the inclusion of the acquisition premium in BNSF’s URCS.<sup>6</sup>

Premium-generated maximum rate increases are not limited to captive shippers pursuing large SAC cases before the Board. The Board also sets maximum relief in mid-size Simplified SAC cases, as well as in small cases decided under its Three Benchmark test, at the greater of the jurisdictional threshold or the maximum R/VC ratios determined under its Simplified SAC and Three Benchmark tests. Inclusion of the

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<sup>6</sup> If acquisition premium related cost of capital impacts are included, the impact on WFA/Basin Electric increases to \$31.5 million over the remaining life of the rate prescription.



acquisition premium in BNSF's URCS will decrease the amount of rate relief available to all shippers in all maximum rate cases brought before the Board – large, medium, and small. V.S. Crowley/Fapp at 21-24.

### **3. Commercial Negotiations**

The Board has encouraged shippers and carriers to utilize the Board's maximum rate standards to resolve rate disputes through commercial negotiation. Captive shippers frequently invoke the Board's standards in their commercial negotiations with their rail carriers. Premium-infused increases in BNSF's variable costs not only impact litigation, they also impact commercial negotiations, since the maximum rate floors used in these negotiations increase just as they would in actual litigations between BNSF and its shippers. *Id.* at 25-26.

### **4. Revenue Adequacy**

Congress has directed the Board to make annual determinations of each major railroad's "revenue adequacy" (49 U.S.C. § 10704(a)(3)), and the Board does so.<sup>7</sup> The Board currently makes these determinations by comparing each major railroad's annual rate of return on its net investment to the industry average cost of capital

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<sup>7</sup> See, e.g., *R.R. Revenue Adequacy—2009 Determination*, STB Ex Parte No. 552 (Sub-No. 14) (STB served Nov. 10, 2010) at 1 and App. B. ("*Revenue Adequacy—2009*") *R.R. Revenue Adequacy—2008 Determination*, STB Ex Parte No. 552 (Sub-No. 13) (STB served Oct. 26, 2009); *R.R. Revenue Adequacy—2007 Determination*, STB Ex Parte No. 552 (Sub-No. 12) (STB served Sept. 26, 2008); *R.R. Revenue Adequacy—2006 Determination*, STB Ex Parte No. 552 (Sub-No. 11) (STB served May 6, 2008) ("*Revenue Adequacy—2006*") ; *R.R. Revenue Adequacy—2005 Determination*, STB Ex Parte No. 552 (Sub-No. 10) (STB served Oct. 23, 2006); *R.R. Revenue Adequacy—2004 Determination*, STB Ex Parte No. 552 (Sub-No. 9) (STB served Nov. 23, 2005).

calculated by the Board for that year.<sup>8</sup> If the carrier's rate of return is equal to or greater than the industry average cost of capital, it is deemed revenue adequate; if the carrier earns less than the industry average cost of capital, it is deemed revenue inadequate.<sup>9</sup>

The Board recently found that the industry average cost of capital in 2010 equaled 11.03%.<sup>10</sup> If BNSF's rate of return on its 2010 net investment is calculated without the addition of the acquisition premium, it equals 9.22%. *Crowley/Fapp* at 24. If the acquisition premium is excluded, BNSF's rate of return on its 2010 net investment equals 10.05%. *Id.* Thus, inclusion of the acquisition premium moves BNSF further away from a Board determination that the carrier is "revenue adequate."

The Board's revenue adequacy determinations play a central role in the application of the Board's "revenue adequacy" constraint in large rate cases. *See Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520, 535 (1985) ("*Coal Rate Guidelines*"). This constraint calls for moderation of rail rates charged by revenue adequate carriers. To date, however, this constraint has never been applied by the Board to provide any rate

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<sup>8</sup> *See Standards for R.R. Revenue Adequacy*, 364 I.C.C. 803 (1981), *as modified*, *Standards for R.R. Revenue Adequacy*, 3 I.C.C. 2d 261 (1986), and *Supplemental Reporting of Consolidated Info. for Revenue Adequacy Purposes*, 5 I.C.C. 2d 65 (1988). Revenue adequacy is determined by a "mechanical" process, whereby the railroad's adjusted net railway operating income is compared with its tax adjusted net investment base to develop a tax adjusted return on investment. *See, e.g., Revenue Adequacy—2009* at 1 and App. B.

<sup>9</sup> *Id.*

<sup>10</sup> *See Railroad Cost of Capital—2010*, STB Ex Parte No. 558 (Sub-No. 14) (STB served Oct. 3, 2011) at 2.

relief to captive rail shippers. Inclusion of the acquisition premium makes it even less likely that a shipper will ever be able to invoke this constraint in a case involving BNSF.

The Board's revenue adequacy determinations also play an important role in setting maximum R/VC ratios in small rate cases using the Board's Three Benchmark method. One input in determining the maximum Three Benchmark R/VC ratio is the Revenue Shortfall Allocation Method ("RSAM") ratio. V.S. Crowley/Fapp at 23-24. This metric measures the average markup over variable cost that the defendant railroad would need to charge all of its traffic priced above an R/VC ratio of 180% in order for the railroad to be deemed revenue adequate under the Board's standards. Inclusion of the acquisition premium in the revenue adequacy calculation increases RSAM by increasing the revenues BNSF needs to collect to be deemed revenue adequate, and increases the resulting maximum R/VC ratios set under the Three Benchmark Method. *Id.* at 24.

#### **E. Congressional Concern**

On March 22, 2011, ten United States Senators sent a letter to the STB expressing their concern about the potential inclusion of the Berkshire acquisition premium in BNSF's regulatory rate base ("Franken Letter"). The ten Senators are Al Franken, David Vitter, Tom Harkin, Herb Kohl, Tim Johnson, Mary L. Landrieu, Mark L. Pryor, Michael B. Enzi, Amy Klobuchar, and Jon Tester. Among the concerns raised by the Senators in their joint letter were the following:

- "Berkshire Hathaway recently acquired BNSF Railway for approximately \$7.3 billion over the company's book value. Allowing this and future acquisition premiums to be included

in a railroad's regulatory rate base raises serious concern for captive rail customers.” *Id.* at 1.

- “[W]e are troubled by the STB’s practice of permitting the inclusion of acquisition premiums in its evaluation of a railroad’s revenue adequacy. . . . We urge you to consider returning to [a predecessor cost] model.” *Id.*

- “[B]y including an acquisition premium in the capital asset base, a railroad is able to inflate artificially the revenue-to-variable cost ratio of 180 percent that is required by statute for a shipper to bring a rate dispute before the STB. . . . If the purchase of a railroad includes an acquisition premium over book value and the railroad is allowed to revalue its property and equipment costs upward to reflect that premium, then the variable cost calculation will increase and the likelihood that shippers will be able to show that rates exceed 180 percent of variable costs will decrease. We do not think this is what Congress intended when it established this threshold.” *Id.*

- “Unlike other railroad mergers, the Berkshire/BNSF transaction did not involve the merger of two railroads, and hence there can be no hope that this transaction will increase rail efficiencies that might justify the premium paid. . . . Furthermore, Berkshire Hathaway’s acquisition of BNSF was not subject to pre-approval by the STB, and thus the possible impact of the acquisition premium on the railroad industry, shippers, and the economy has not yet been subject to any prior Board review proceedings.”

- “We also understand that no other federal regulatory agency allows this practice [inclusion of acquisition premiums in regulated rate bases in comparable cases].”

The Senators urged the Board to “initiate a proceeding” to address their concerns.

On April 11, 2011, Senator John Thune wrote a letter to the Board where he expressed concerns similar to those raised in the Franken Letter. In his letter, Senator Thune observed that inclusion of the acquisition premium Berkshire paid to acquire

BNSF “could factor into BNSF’s asset base, and, in turn, impact STB calculations used to review and set certain rail rates.” *Id.* at 1 (“Thune Letter”).

Senator Thune also addressed specifically the prescribed maximum rates paid by WFA/Basin Electric, concluding that “Western Fuels and Basin Electric should not be subject to higher rates than they would have been in the absence of the BNSF acquisition by Berkshire”:

In 2009, Basin Electric and Western Fuels won an estimated \$345 million judgment against BNSF for rate relief on the over 8 million tons of coal hauled annually from the Powder River Basin of Wyoming. As part of the judgment, the shippers were . . . granted capped rates for the next 16 years. These capped rates are calculated using the same variable cost model that could be influenced by a write up in the value of BNSF assets due to the purchase premium. Given that there is well over \$200 million at stake in the form of future rate calculations, I believe this issue should be examined closely by the STB. Simply put, Western Fuels and Basin Electric should not be subject to higher rates than they would have been in the absence of the BNSF acquisition by Berkshire.

*Id.* at 2.

#### **F. These Proceedings**

On May 2, 2011, WCTL filed its Petition asking that the Board institute a declaratory order proceeding to resolve the dispute concerning the proper regulatory treatment of the Berkshire acquisition premium, and, at the conclusion of that proceeding, to issue an order declaring that it will adjust BNSF’s URCS, starting in 2010, to exclude the premium.

Thereafter, APPA, NRECA, EEI, NARUC, The National Industrial Transportation League, and Consumers United for Rail Equity submitted letters to the

STB supporting WCTL's request to institute a declaratory order proceeding, as did the USDA and Senator Amy Klobuchar.

In its letter dated June 20, 2011, USDA emphasized the consumer interests at stake in this proceeding:

The Board's current procedures allow railroad acquisition/merger premiums to be passed through to railroad customers. The Board's current procedures unfavorably impact rail rates paid by utilities serving rural areas, resulting in higher rates for electricity than would otherwise be the case. These higher electricity rates increase farm production costs and reduce the economic vitality of rural areas. . . . [T]he Board's current policies regarding railroad acquisition/merger premiums result in higher rail rates for grain and oilseed shippers, particularly for those distant from barge transportation and are thereby most reliant upon rail services.

*Id.* at 1 ("USDA Letter"). Senator Klobuchar's letter (dated Sept. 13, 2011) also highlights the fundamental consumer interests raised by any pass through of acquisition premiums to BNSF shippers:

BNSF is one of the largest railroads in the nation, and is the primary rail provider in my state of Minnesota. Utilities, farmers and ranchers, ethanol producers, and manufacturers may be harmed significantly, and their negotiating position with BNSF diminished if the premium is allowed to stand. I urge you to promptly give full and fair consideration to [WCTL's] petition.

*Id.* at 1 ("Klobuchar Letter").

On May 23, 2011, BNSF filed a reply ("BNSF Reply") to WCTL's Petition. In its Reply, BNSF asked the Board to deny WCTL's Petition. *Id.* at 1-2. Alternatively, if the Board decided to institute a declaratory order proceeding, BNSF

asked that the proceeding be expanded to address the inclusion of the acquisition premium in the Board's annual determinations of BNSF's revenue adequacy.

In its decision served on September 28, 2011, the Board initiated a declaratory order proceeding "to resolve the controversies raised by WCTL and BNSF." *Id.* at 2. The Board directed WCTL, BNSF, and other interested members of the public, to "address the effect of the subject net investment base write-up on the annual URCS and revenue adequacy determinations beginning in the year 2010." *Id.* at 2-3. The procedural schedule adopted by the Board calls for the parties of record to submit opening evidence and argument on October 28, 2011.

### **ARGUMENT**

Coal Shippers/NARUC respectfully request that the Board resolve the dispute between WCTL and BNSF by (i) removing the acquisition premium from BNSF's URCS costs, starting with BNSF's 2010 URCS, and (ii) by removing the premium from BNSF's rate base for revenue adequacy purposes, starting with the Board's 2010 annual revenue adequacy determination.

Granting this relief is consistent with basic notions of regulatory fairness, and basic principles of rate regulation employed by all other federal and state regulators. Granting this relief also does not single BNSF out for disparate treatment. Berkshire's acquisition of BNSF differs significantly from prior acquisitions the Board has considered. Unlike prior mergers, Berkshire's acquisition of BNSF was not one

approved by the Board, involves a far larger premium than those involved in prior mergers, and involves no synergies that can offset acquisition premiums.

**I.**

**IT IS FUNDAMENTALLY UNFAIR FOR CAPTIVE BNSF CUSTOMERS' RATES TO INCREASE SIMPLY BECAUSE BERKSHIRE PAID A \$8.1 BILLION PREMIUM TO ACQUIRE BNSF**

The Board should remove the acquisition premium from BNSF's URCS because it is fundamentally unfair for captive shipper's rates to increase due solely to BNSF's change in ownership. No other public regulator would permit this result, and neither should the Board.

**A. Captive BNSF Customers Should Not Pay Higher Rates for the Same Rail Service**

One of the first principles of utility rate regulation is that "a mere change in ownership should not result in an increase in the rate for service *if the basic service rendered itself remains unchanged.*" *Williston Pipeline Co.*, 21 FERC ¶ 61,260, 61,634 (1982) (internal citation omitted), *aff'd on this point sub nom. Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1486, 1527-28 (D.C. Cir. 1984) (*Farmers Union II*); V.S. Wilson at 15 ("Public utility regulators have consistently held that a mere change in ownership without any changes in basic service should not result in an increase in rates . . . .").

The rationale for this rule is simple and straightforward: customers should not have to pay higher rates as a result of a transaction over which they had no control



and from which they do not benefit. *See* V.S. Wilson at 16 (“Where a transaction is an acquisition . . . without any change in basic management, operations, or service, there is no possibility of public benefits, and thus no legitimate justification for inclusion of the premium in the rate base.”)

Berkshire’s acquisition of BNSF constitutes a classic example of a “change in ownership . . . [where] *the basic service rendered itself remains unchanged.*” *Williston Pipeline Co.* at ¶ 6,634. As BNSF’s top management has repeatedly emphasized:

- **The BNSF acquisition resulted in no notable changes to BNSF employees.** *See* BNSF Conference Call with Employees, Statement of Matt Rose – Chairman, President and CEO (SEC Form 425, filed Nov. 9, 2009) (“The reality is that the way Berkshire manages their assets, there’s going to be very little change to employees. And that’s by design. The last thing Warren Buffett would do is buy a company and then want to see a bunch of changes to the leadership team and to the employees who have delivered the types of results of what he’s buying it for.”)

- **The BNSF acquisition resulted in no changes to corporate management or structure.** *See id.* (“I recognize up front that everybody’s going to be asking things like, ‘What does this mean to our corporate office?’ ‘What does it mean about the name change, the color of the locomotives?’ Those are all things classical merger-type issues that we’ve dealt with in the Burlington Northern to Santa Fe and in the failed CN merger. Where’s the headquarters going to be? None of those issues are associated with this acquisition. The big difference is that we’re going to be a wholly owned subsidiary of Berkshire Hathaway, which is a publicly traded company. That is going to be a little different for certain people, but for the vast majority of people it’s going to be the same as you were yesterday, the same as you’ll be tomorrow.”)

• **The BNSF acquisition resulted in no changes in BNSF operations, service, or customer relations.** *See* Letter from John Lanigan, Executive Vice President and Chief Marketing Officer, to All BNSF Customers on BNSF/Berkshire Hathaway Transaction (dated Nov. 4, 2009) (SEC Form 425, filed Nov. 4, 2009) (“[Customers] will not see any changes in the weeks and months ahead. Our leadership will remain in place and focused on providing value to our customers. We will continue our efforts to provide you with the same outstanding service you have come to expect from BNSF. Your day-to-day contacts and the way we interact with you will not change. We will continue to work with other railroads as we always have to provide interline services. In other words, you should expect business as usual.

Berkshire’s hands-off approach to BNSF was by design. *See, e.g.,* Voice Message from BNSF CEO Matt Rose to Employees (dated Nov. 6, 2009) (SEC Form 425, filed Nov. 6, 2009) (“Berkshire has a tremendous track record of buying well-run, well-maintained companies and leaving them alone in order for them to fulfill their mission”). Similarly, Mr. Buffet stated in an interview:

[Q]: [W]ill Berkshire directly be involved in the management of BNSF, and will the management structure change?

[Warren Buffet]: No, it won’t. It’s very simple. We’ve got 20 people in Omaha, and there isn’t one of them that knows how to run a railroad.

[Q]: Alright, next question. Will this transaction impact employment levels positively or negatively?

[Warren Buffet]: Well, I don’t think it changes anything, really, in that respect. . . . [N]othing in our ownership really has any effect on employment.

[Q] Okay. . . . How do you balance negotiating fair wages, health care, and a good work environment with Berkshire Hathaway earnings?

[Warren Buffet]: Well, you'll do it just like you've managed it in terms of BNSF earnings. And there will be no involvement by me or anybody else in Omaha in terms of labor or in terms of purchasing or in terms of what locomotives you buy, anything of the sort. It's – we bought it because it was well-managed. If . . . we had to bring management to BNSF, both of us would have been in trouble.

BNSF Video News, Interview with Warren Buffett, Interviewer: Matt Rose (Dec. 3, 2009) (SEC Form 425, filed Dec. 21, 2009).

Since Berkshire's acquisition of BNSF is clearly one where ownership has changed, but service has not, BNSF's captive shippers should not be required to pay higher rates. Indeed, Berkshire itself has recognized, and abided by, this very principle. In 2006, Berkshire acquired PacifiCorp, a regulated utility, through another Berkshire subsidiary. In seeking regulatory approval for this acquisition, Berkshire's subsidiary stipulated that it would not seek a recovery of an acquisition premium because the acquisition would not change PacifiCorp's basic services:

[Berkshire's subsidiary] recognizes the inability to earn a regulated return on the acquisition premium is simply the price paid by shareholders for the opportunity to earn a regulated return on the remainder – the book value or original cost (less depreciation) for ratemaking purposes.

V.S. Wilson at 16-17 (citation omitted). Unfortunately, Berkshire and BNSF decided not to make a similar stipulation in this proceeding

**B. No Regulator Would Allow the Acquisition Premium to Be Included In BNSF's URCS**

Public utility regulators consistently deny requests for inclusion of acquisition premiums in regulated utility rate bases. V.S. Wilson at 10-12; V.S. Crowley/Fapp at 32-34. These denials come about for several reasons, all of which are rooted in principles of fundamental fairness to utility ratepayers. They include denying recovery where there is no change in service (discussed above), denial of recovery because it is unfair to require ratepayers to pay for the same asset twice (once at original cost and again at the acquisition cost)<sup>11</sup>, and denial of recovery where circularity problems may exist (acquirers pay artificially inflated prices for assets in hopes of recovering inflated returns from ratepayers). V.S. Wilson at 5-20.

Some regulators do recognize a “benefits exception” to this general rule. As Dr. Wilson explains, “in some (but not all) public utility merger or acquisition cases in which it was shown that the merger or acquisition would produce economies in the provision of public utility service that would have not been possible but for the

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<sup>11</sup> This double payment frequently involves double recovery of inflation-based rate increases since in most regulatory settings, including the STB, a nominal cost of capital (which includes an inflation recovery component) is applied to an original cost rate base (which does not) to determine permitted returns to be charged ratepayers. If the same assets are written up to fair market value (which reflects inflation), and, a nominal cost of capital is again applied to that asset base, “double compensation for inflation” occurs because inflation is captured twice – “once by . . . including the risk of inflation in the [rate of return] component of rates and again by including inflated property value in an acquisition premium adder to [the] rate base.” V.S. Wilson at 13-14.

transaction, public utility regulators have allowed the recovery through rates of a corresponding amount of any acquisition premium.” *Id.* at 22.

No public utility regulator would allow the inclusion of the Berkshire premium in a regulated rate base on the facts of this case. *Id.* at 4. Any such inclusion is fundamentally unfair because it requires captive BNSF customers to pay higher rates for same service, forces them to pay twice for the same assets, and offers absolutely no offsetting benefits. The Board should follow suit here.

In some past cases, the Board has held that acquisition premium principles developed in rate regulation of entities other than railroads is inapposite to the STB’s regulation of railroads because a “circularity” problem does not exist for regulated railroads. *See Conrail*, 3 S.T.B. at 262. According to the Board, no one would buy a railroad at an inflated price in hopes of earning inflated returns because most rail rates are not subject to rail regulation. *Id.* The Board should reconsider this position for four reasons.

**First**, circularity is simply one example of the larger principle at stake: fairness to ratepayers. Public utility regulators frequently deny pass-through of premiums to ratepayers in arms-length transactions where the acquirer pays a reasonable – not inflated – price for a utility and no “circularity” exists in the form of regulatory gaming. *V.S. Wilson* at 9-10, 15-17; *Farmers Union II*, 734 F.2d at 1528 n.78 (rejecting the argument that FERC was required to include an acquisition premium in an oil pipeline company’s rate base “if assets were purchased in good faith and at arms-length”). In

such cases, premium recovery is denied for other reasons: there is no change in service, there are no offsetting benefits, or there are concerns about double payments.

**Second**, as Dr. Wilson demonstrates, the fairness principles underlying the premium exclusions do not require “*total* circularity:”

While the ability to include acquisition premiums in rate base would . . . be less likely to cause spiraling asset acquisition *prices* in industries where most consumers are protected by competition, it would, nonetheless, still cause an unwarranted increase in the *value* of the acquired company, creating a circularity problem. It would also result in unwarranted rate base and rail rate increases for captive shippers paying regulated rates. In other words, there does not need to be *total* circularity in order for ratemaking to be tainted by an acquisition premium. This is not about incentives to pay inflated prices, or whether Berkshire was incented to pay more in the hopes of achieving higher rates of return. Berkshire’s incentives or motivations should not matter. It is enough that a portion of a carrier’s traffic is affected (its captive traffic), because to allow the premium pass through would be unreasonable and result in excessive rates for those consumers whose rates are rate base regulated because of an inflated asset value.

V. S. Wilson at 19-20.

**Third**, as Crowley/Fapp demonstrate “the value of today’s railroads is greatly dependent upon regulatory issues.” V.S. Crowley/Fapp at 37. The Board need look no further than the many statements emanating from the Association of American Railroads (“AAR”), and senior railroad executives, for proof of this fact. The AAR, and senior railroad officials, are constantly asserting that the STB’s regulatory policies can and do impact the market value of large railroads. *See id.* at 38-39.

**Fourth**, the Board's assertions concerning circularity have in fact been *dicta* in all recent large merger cases. As discussed below, the STB has been approving the pass-through of merger premiums by applying its version of the "public benefits" exception. In *Conrail*, the Board held that that merger cost reductions in that case would offset merger acquisition premiums (*id.*, 3 S.T.B. at 263), and the same holds true in other major mergers the Board has approved. See V.S. Crowley/Fapp at 28-30. The Board can and should apply the same public benefits test in this case, but, since there are no public benefits, reach a different conclusion: exclude the \$8.1 billion premium from BNSF's URCS.

**C. Public Officials Are Calling On the Board to Do the Right Thing: Exclude the Premium From BNSF's URCS**

The potential inclusion of the \$8.1 billion premium in BNSF's URCS has generated a firestorm of public concern. To date, eleven United States Senators, the USDA, and NARUC have weighed in and made their views clear.

Ten United States Senators signed on to the Franken Letter. These Senators have "serious concern[s]" about the Board's inclusion of the Berkshire premium in BNSF's regulatory rate base and urged the Board to "consider returning to [a predecessor cost] basis." *Id.* The reason the Senators took this position is clear: they jointly believe that it is manifestly unfair for captive rail shippers' rates to increase, and the Board's regulatory jurisdiction to decrease, simply because Berkshire paid a premium to acquire BNSF. *Id.*

Senator John Thune wrote his own letter to the Board expressing his concerns that the Berkshire premium “could factor into BNSF’s asset base, and, in turn, impact STB calculations used to review and set certain rail rates.” Thune Letter at 1. Senator Thune requested that the Board exclude the premium in calculating the maximum rates the Board has prescribed to apply on the rail traffic of one of his constituents (Basin Electric) because Basin Electric “should not be subject to higher rates than they would have been in the absence of the BNSF acquisition by Berkshire.” *Id.* at 2.

Senator Amy Klobuchar recently wrote a letter to the Board expressing concerns that “[u]tilities, farmers and ranchers, ethanol producers, and manufacturers may be harmed significantly, and their negotiating position with BNSF diminished,” if the premium is allowed to be included in BNSF’s regulatory rate base. *See* Klobuchar Letter at 1.

The USDA wrote a letter to the Board earlier this year concerning the Berkshire premium. USDA expressed its grave concerns over the impact of passing this premium through to captive BNSF customers would have both in the form of “higher electricity rates” (as BNSF captive utilities pass-through premium generated rate increases to farmers) and “higher rail rates for grain and oilseed shippers.” *See* USDA Letter at 1.

NARUC, which represents all state utility regulators, joins Coal Shippers in this filing, and has tendered a verified statement from its Executive Director, Charles Gray. Mr. Gray informs the Board that NARUC opposes the inclusion of the \$8.1 billion



premium in the STB's URCS, and BNSF's revenue adequacy rate base, because such inclusions "would be an affront to fundamental principles of public utility regulation" and produce results that are manifestly unfair to BNSF's captive shippers. V.S. Gray at 2-3. Mr. Gray also emphasizes that the ultimate victims of any pass-through of the Berkshire premium to BNSF's captive shippers will be electric utility customers served by BNSF-captive utilities, as well as "farmers, manufacturers, and other businesses that rely on BNSF freight rail service and have no effective" options to BNSF rail service. *Id.* at 2.

The Board is charged with protecting the public interest, and in carrying out its duties to the public, the Board should give particular weight to the views of other public officials who are also charged with protecting these same public interests.

## **II. BNSF TENDERS NO CREDIBLE DEFENSE FOR THE INDEFENSIBLE: INCLUSION OF THE \$8.1 BILLION ACQUISITION PREMIUM IN ITS URCS**

In its Reply, BNSF tendered two arguments in support of its claim that its captive shippers should bear the costs of the \$8.1 billion Berkshire acquisition premium: (i) this result is mandated by prior Board merger decisions, and (ii) this result is mandated by GAAP. Neither assertion is correct.

### **A. Prior Board Merger Decisions Support the Removal of the Premium From BNSF's URCS**

BNSF claims that prior Board precedent in rail merger cases holds that acquisition premiums must be included in the acquired carrier's variable costs, citing such cases as: *Conrail*; *Burlington Northern R.R. Co. – Control and Merger* – *Santa Fe*

*Pac. Corp.*, 10 I.C.C.2d 661 (1995) (“*BN/Santa Fe*”); and *Union Pac. Corp. – Control and Merger – Southern Pac. Rail Corp.*, 1 S.T.B. 233 (1996) (“*UP/SP*”).

Each of these cases involved a merger of two or more railroads, was subject to prior Board approval, and in approving these mergers, the Board found that merger synergies would generate cost reductions for the merged carriers’ customers. As *Crowley/Fapp* demonstrate, the projected merger synergies dwarfed the acquisition premiums involved in each case:

<b><u>Comparison of Synergies to Acquisition Premium in Recent Mergers</u></b>			
<u>Amount (millions)</u>			
<u>Merger</u>	<u>Projected Synergies Per Year</u>	<u>Acquisition Premium<sup>1/</sup></u>	<u>Period to Recover Premium<sup>2/</sup></u>
(1)	(2)	(3)	(4)
1. NS/CSXT Conrail	\$1,000	\$3,671	3.7
2. UP – SP	\$659	\$2,729	4.1
3. BN - ATSF	\$453	\$1,423	3.1

<sup>1/</sup> Net premium included in URCS.  
<sup>2/</sup> Column (3) divided by Column (2)

V.S. *Crowley/Fapp* at 29.

*Conrail*, *BN/Santa Fe*, *UP/SP* and other major rail mergers were premised on the assumption that the mergers would reduce the merged carrier’s costs, not increase them, with the merged carrier’s customers being the ultimate beneficiaries of the merger-generated cost reductions. Berkshire’s acquisition of BNSF is dramatically different than

*Conrail*, *BN/Santa Fe*, and *UP/SP*. Unlike those transactions, Berkshire's acquisition of BNSF did not involve a merger of two or more railroads, was not approved by the Board, and the acquisition contains no synergies or efficiencies.

The bottom line is that unlike rail mergers the Board has approved, BNSF's URCS costs will increase, not decrease, as a result of the Berkshire transaction, and that this increase is very significant as the premium Berkshire paid to acquire BNSF is five times greater than the *BN/Santa Fe* merger premium, three times greater than the *UP/SP* merger premium, and twice the size of the *Conrail* merger premium.<sup>12</sup>

Board precedent teaches that the Board approves mergers and permits acquisition premiums when it finds the public will benefit in the form of lower carrier costs, lower rates, and better service. *See generally* 49 C.F.R. § 1180.1 (c) ("The Board believes that mergers serve the public interest only when substantial and demonstrable gains in important public benefits – such as improved service and safety, enhanced competition, and greater economic efficiency – outweigh . . . merger-related harms."); *Conrail*, 3 S.T.B. at 249 ("the clear trend since 1980 has been that railroad efficiencies

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<sup>12</sup> BNSF claims that the Board did not rely on any proposed cost reductions in approving the Blackstone Group's acquisition of CNW Corp., which owned the Chicago and Northwestern Transportation Company ("CNW"), citing *Blackstone Capital Partners L.P. – Control Exemption – CNW Corp. and Chicago and North Western Transp. Co.*, 5 I.C.C.2d 1015 (1989). In fact, the "central issue" in this case involved CNW's representations that its acquisition by Blackstone would generate substantial cost savings and revenue infusions, which the Board relied upon in approving the acquisition. *See* V.S. Crowley/Fapp at 30. These projected financial benefits were substantially greater than the small acquisition premium. *Id.* at 31.

achieved through mergers or other means have been largely passed through to shippers in the form of lower rates and improved service”).

Application of the same public interest standards here requires that the Board exclude the \$8.1 billion acquisition premium from BNSF’s URCS. While the Board has no jurisdiction to reject Berkshire’s acquisition of BNSF, it can act to ensure that the public interest is protected by removing the acquisition premium from BNSF’s URCS. In so doing, the Board will insure that captive shippers’ rates will not increase automatically as a result of the Berkshire acquisition.

**B. GAAP Accounting Does Not Govern Regulatory Ratemaking**

Virtually every page of BNSF’s Reply cites to GAAP. BNSF argues that since BNSF’s acquisition premium results from the application of GAAP purchase accounting standards, that fact is dispositive here. However, it clearly is not. As Dr. Verrecchia explains, “GAAP’s exclusive purpose is to establish accounting rules and standards for *financial reporting* by companies . . . and [is not] designed or are charged with addressing the ratemaking function of regulators”:

GAAP consists of a collection of accounting rules and standards for financial reporting by all regulated and unregulated companies. The intent and purpose of GAAP, generally, is to ensure consistency in accounting practices; the accurate, full, and timely reporting of financial data; reporting continuity; and fairness to companies, investors, creditors, and the public who rely on statements to make sound decisions and determine a company’s financial health. While GAAP standards are fairly extensive, GAAP’s exclusive purpose is to establish accounting rules and standards for *financial reporting* by companies. Neither GAAP, nor the Financial Accounting Standards Board (FASB), which establishes the standards of financial accounting and reporting for nongovernmental entities,

are designed to or are charged with addressing the ratemaking function of regulators. . . . Regulators with jurisdiction over certain companies and rates and services, and not accountants or accounting rules, are responsible for establishing protections against unreasonable rates for all jurisdictional activities.

V.S. Verrecchia at 3.

Dr. Verrecchia's views about the interplay of GAAP and regulatory ratemaking are shared by the courts and by leading treatise writers. *See, e.g., Farmers Union I*, 584 F.2d at 418 (holding that "it is rates, not bookkeeping, that [the Interstate Commerce Act] requires to be reasonable, and there is no assurance . . . that reasonable accounting measures translate automatically into reasonable rates" and criticizing "the ICC's current unexplained insistence on irrevocably hitching its ratemaking theory to its accounting rules"); Leonard S. Goodman, *The Process of Ratemaking* 160 (1998) ("[a]n agency is not required to follow accounting convention or GAAP" in its rate regulation).

Inclusion of the premium in BNSF's URCS costs is a ratemaking issue because the Board uses R/VC ratios calculated with URCS costs for ratemaking purposes, including the establishment of its regulatory jurisdiction (the 180% of variable cost jurisdictional threshold), as well as the establishment of maximum R/VC ratios in SAC cases, in Simplified SAC cases, and in Three Benchmark cases.

Ratemaking principles, not GAAP or other accounting principles, govern here because, in this case, "reasonable accounting measures" unequivocally do not "translate automatically into reasonable rates." *See* V.S. Verrecchia at 8 ("The mechanical employment of this [GAAP] accounting technique in a ratemaking

proceeding may produce unintended and skewed regulatory results.”); V.S. Wilson at 23-24 (“Utility commissions have consistently rejected arguments that accounting procedures should dictate ratemaking in yielding just and reasonable rates.”).<sup>13</sup>

The fact that GAAP principles cannot and should not govern here is perhaps best exemplified by the Board’s prescription of maximum SAC R/VC ratios. The Board’s SAC test calls upon the complainant shipper to model a hypothetical stand-alone railroad (“SARR”) to serve the traffic at issue if the rail industry were free from entry barriers. *Major Issues* at 7. Under the SAC test, the challenged rate “cannot be higher than what the SARR would need to charge to serve the complaining shipper while fully covering all of its costs, including a reasonable return on investment.” *Id.*

The Board uses its MMM procedure to allocate SAC costs, in cases where SARR revenues exceed SAC, and sets the maximum MMM ratio for eligible issue traffic so that that if all traffic group rates with R/VC ratios above the maximum MMM R/VC ratio are reduced to the maximum MMM R/VC ratio, SARR revenues for the traffic group will equal SAC for the involved time period. *Id.* at 14-15.

It makes absolutely no sense to increase a maximum rate set by a prescribed MMM R/VC ratio due to the inclusion of an acquisition premium in the MMM variable costs. The fact that a defendant carrier has been acquired in a transaction

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<sup>13</sup> Congress has recognized in other contexts that the Board must not apply GAAP blindly, but instead must consider the practical implications of GAAP’s application. *See* 49 U.S.C. §§ 11142, 11161 (Board rules governing railroad accounting shall conform to GAAP, but only to “[t]o the maximum extent practicable”).

where its acquirer paid an acquisition premium should have absolutely no impact on the rate level “the SARR would need to charge to serve the complaining shipper while fully recovering all of its costs, including a reasonable return on investment.” *Id.* at 7. Here, Berkshire paid a premium to acquire BNSF; it did not pay a premium to acquire a SARR. Blindly applying GAAP standards produces an absurd result: prescribed rates based on MMM R/VC ratios increasing due to a change in BNSF’s (not the SARR’s) ownership. *See V.S. Crowley/Fapp* at 41-43.

Similarly, BNSF’s repeated citations to the now dated Railroad Accounting Principles Board (“RAPB”) Final Report, issued nearly 25 years ago in 1987, are inapposite. *See Railroad Accounting Principles, Final Report* (Sept. 1, 1987). The RAPB’s Final Report contained a non-binding recommendation that the ICC utilize GAAP costs in valuing rail business combinations. *Id.*, Vol. 2 at 39. Even at that time, the RAPB’s recommendation was highly controversial. *Id.*, Vol. 1, Statement of RAPB Member Richard E. Briggs at 38 (“In truth, no other basic recommendation by the Board drew as much opposition and so little support”). The RAPB also made clear that its recommendation of the use of GAAP accounting for rail acquisitions was subject to a significant caveat: “other measures of value may be used where GAAP cost reasonably cannot be viewed as a meaningful regulatory measure of value.” *Id.*, Vol. 2 at 47.

When the RAPB issued its Final Report, the ICC did not rely directly on the use of variable costs in setting maximum rail rates on all rail traffic subject to its regulatory jurisdiction. *See id.*, Vol. 2 at 46 (GAAP cost [is not] . . . used directly in

ratemaking). Nor were acquisition premiums a major concern in 1987 since most carrier acquisitions at that time involved a write-down, not a write-up, in the acquired carrier's assets.<sup>14</sup> However, as Mr. Briggs – who was the railroad industry's representative on the RAPB – presciently observed, should such write-ups begin to occur, their inclusion in regulatory costs would be fundamentally unfair to captive rail shippers:

If the purchased railroad is financially strong, continued inflation will have driven up the current values of its assets well above depreciated original costs of its long-lived investments. The acquisition price will, therefore, be higher and the new owner would have the ability to raise rail rates to higher levels than would be allowed under current ICC practice. Shippers which have paid once for the impact of inflation could be called upon to pay twice for the same escalation of values. This is the same type of double count for inflation the Board assiduously avoided in its pronouncements on abandonment and cost of capital questions.

*Id.*, Vol. 1 at 39. Mr. Briggs got it right, and particularly on the unique facts of this case, “GAAP cost reasonably cannot be viewed as a meaningful regulatory measure of value.”

*Id.*, Vol. 2 at 47.<sup>15</sup>

Governing Board precedent teaches that costing is different from ratemaking. *See Rules to Govern the Assembly & Presenting of Cost Evidence*, 337

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<sup>14</sup> *See Assoc. of Am. R.R.s v. ICC*, 978 F.2d 737, 740 (D.C. Cir. 1992) (“Because economic conditions in the railroad industry affect the value of rail assets, a net investment base calculated by acquisition costs will often be smaller than one calculated using original cost.”).

<sup>15</sup> The RAPB also was of the view that STB maximum rate policies had no impact on the value of rail assets, a position that the railroad industry strongly disputes today. *See V.S. Crowley/Fapp* at 37-40.



I.C.C. 298, 382 (1970) (“A definite distinction should be made between the determination of costs and pricing or ratemaking.”); *Board of Trade of Kansas City, Mo. v. United States*, 314 U.S. 584, 546 (1942) (“The process of ratemaking is essentially empiric . . . resulting from factors that must be valued as well as weighed.”); *Coal Rate Guidelines*, 1 I.C.C.2d at 551 (Commissioner Strenio concurring) (“rate reasonableness is a judgment call” that should produce “fair and efficient outcomes”).

This case is not governed by GAAP or any other accounting principles. Instead, Coal Shippers/NARUC call upon the Board to look at the regulatory outcomes of including the \$8.1 billion premium in BNSF’s rate base – automatic increases in captive shippers’ rates – due solely to a change in BNSF’s ownership. This is a manifestly unfair ratemaking outcome which the Board can and should prevent.

### **III. THE PROPER REMEDY IS CLEAR: THE BOARD SHOULD EXCLUDE THE PREMIUM FROM BNSF’S URCS**

The proper remedy is clear: the Board should declare that it will not include the Berkshire acquisition premium in BNSF’s URCS, starting in 2010, and direct its staff to implement this declaration by making the necessary adjustments in the BNSF URCS. Making these adjustments is a simple, straightforward, mechanical exercise. *See* V.S. Crowley/Fapp at 8.

The Board’s authority to order this relief is also clear. Congress has directed that the Board develop variable costs for jurisdictional threshold purposes using the defendant carrier’s “unadjusted” URCS costs “with adjustments specified by the

Board.” See 49 U.S.C. § 10707(d)(1)(B). This statute “broadly delegate[s] to the Board the *authority* to make reasonable adjustments to the variable-costs figures produced by URCS.” *BNSF Ry. v. STB*, 526 F.3d 770, 775 (D.C. Cir. 2008). The Board can and should exercise its broad authority by adjusting BNSF’s URCS to remove the \$8.1 billion acquisition premium.<sup>16</sup>

The Board has also been given the broad authority to determine the maximum reasonableness of rail rates.<sup>17</sup> In its exercise of that authority, the Board has determined that variable costs used in determining the Board’s jurisdictional threshold should also be used to calculate maximum SAC R/VC ratios, maximum Simplified SAC R/VC ratios, and maximum Three Benchmark R/VC ratios.<sup>18</sup> The Board’s approach is intended to streamline the maximum rate process through use of a single set of commonly developed variable costs. *Id.*

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<sup>16</sup> Since this adjustment is simple, straight-forward, and will be made by the Board’s staff, it does not create the asserted “costly burden[s] and complexity” that led the Board to stop making movement-specific adjustments to URCS costs in maximum rate cases. *Major Issues* at 50.

<sup>17</sup> See *Burlington N. R.R. v. STB*, 114 F.3d 206, 210 (D.C. Cir. 1997) (“Because Congress has expressly delegated to the Board responsibility for determining whether a railroad has market dominance and, if so, whether its rate is reasonable, the Board is at the zenith of its powers when it exercises that authority.”) (internal quotation marks omitted).

<sup>18</sup> See *Major Issues* at 14 (variable costs used in SAC cases to develop jurisdictional threshold and maximum MMM R/VC ratios should be calculated using the same URCS procedures); *Simplified Standards for Rail Rate Cases*, STB Ex Parte No. 646 (Sub-No. 1) at 16 (STB served Sept. 5, 2007) (variable costs used to develop jurisdictional threshold, Three Benchmark R/VC ratios, and maximum Simplified SAC R/VC ratios should be calculated using the same URCS procedures).

Once the premium is removed from BNSF's URCS for jurisdictional threshold calculations, the Board should continue to follow its established practice of using the same URCS costs to calculate maximum reasonable R/VC ratios. As applied here, that means use of BNSF URCS costs, adjusted to remove the acquisition premium. This result advances the Board's interest in streamlining the maximum rate process, and also advances the over-riding public interest in protecting captive shippers from paying higher rail rates simply because Berkshire paid a \$8.1 billion premium to acquire BNSF.

**IV.  
THE BOARD SHOULD ALSO REMOVE THE PREMIUM IN MAKING ITS  
ANNUAL DETERMINATIONS OF BNSF'S REVENUE ADEQUACY**

The Board should exclude the \$8.1 billion acquisition premium from its annual determination of BNSF's revenue adequacy determinations for the same reasons it should exclude the premium from BNSF's URCS – it is fundamentally unfair to captive shippers to include the premium in this calculation.

The Board currently uses its revenue adequacy calculations in two different maximum rate case settings. First, revenue adequacy is used in the Board's determination of one of the three benchmarks it applies in small rate cases: RSAM. RSAM measures the average markup over variable cost that the defendant railroad would need to charge all of its traffic priced above an R/VC ratio of 180% in order for the railroad to be deemed revenue adequate under the Board's revenue adequacy standards. *See V.S. Crowley/Fapp* at 23-24.

Inclusion of the acquisition premium in the revenue adequacy calculation increases RSAM by increasing the revenues BNSF needs to collect to be deemed revenue adequate. This result is fundamentally unfair to small shippers, who should not incur higher RSAM R/VC ratios, and resulting higher maximum Three Benchmark R/VC ratios, simply because Berkshire acquired BNSF. *Id.*

The Board also considers the revenue adequacy of a carrier in applying its revenue adequacy constraint in large rate cases. This constraint provides that rates revenue adequate carriers can charge captive shippers should be lower than rates that non-revenue adequate carriers can charge:

Our revenue adequacy standard represents a reasonable level of profitability for a healthy carrier. It fairly rewards the rail company's investors and assures shippers that the carrier will be able to meet their service needs for the long term. Carriers do not need greater revenues than this standard permits, and we believe that, in a regulated setting, they are not entitled to any higher revenues. Therefore, the logical first constraint on a carrier's pricing is that its rates not be designed to earn greater revenues than needed to achieve and maintain this 'revenue adequacy.' In other words, captive shippers should not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs.

*Coal Rate Guidelines*, 1 I.C.C.2d at 535-36.

In 2006, the Board found BNSF to be revenue adequate since its return on investment (11.43% ) exceeded the railroad industry's cost of capital (9.94%).<sup>19</sup> In 2010,

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<sup>19</sup> *Revenue Adequacy—2006* at 1 and Appendix.

BNSF's return on investment, without inclusion of the acquisition premium, equals 10.05%, which is near the 11.03% industry average cost of capital in 2010. However, if the premium is included, BNSF's return on investment drops to 9.22%. *See* V.S. Crowley/Fapp at 24.

Thus, as a direct result of the Berkshire acquisition, BNSF is deemed to have a lower rate of return, making it even more difficult for a captive BNSF shipper to ever be able to successfully invoke the revenue adequacy constraint, a constraint that no shipper has ever successfully invoked in a maximum rate case since the Board seldom finds any major rail carriers to be revenue adequate.<sup>20</sup>

The Board's revenue adequacy tests have been roundly, and correctly, criticized by individual Board members, Congress, and shippers as bearing absolutely no correlation to financial reality.<sup>21</sup> Certainly, Mr. Buffett was not troubled by the Board's

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<sup>20</sup> For example, in its most recent revenue adequacy determination, the Board found that no Class I railroads were revenue adequate. *Revenue Adequacy—2009* at 1.

<sup>21</sup> *See R.R. Revenue Adequacy—1996 Determination*, Ex Parte No. 552 (Sub-No. 1), (STB served Aug. 28, 1997), at 2 (Vice-Chairman Owen states “the premises upon which the agency is charged to determine railroad adequacy . . . are flawed, given today’s regulatory climate and industry economics”); *R.R. Revenue Adequacy Determination—1995*, 1 S.T.B. 167, 168 (1996) (Chairman Morgan recognizes that most railroads remain revenue inadequate despite the fact that the “industry has substantially and steadily improved its performance, as well as its standing in the financial markets”); Staff of S. Comm. On Commerce, Science, and Transp., 111<sup>th</sup> Cong., *The Current Fin. State of the Class I Freight Rail Indus.* (Sept. 15, 2010) at 4 (“While the rail industry’s regulatory filings with the STB portray an industry that is still struggling . . . the railroads’ public financial results tell a different story . . . . In fact, today, the large U.S. rail companies are some of the most profitable publicly-traded companies in the world.”); Comments of WCTL, *Railroad Cost of Capital—2006*, STB Ex Parte No. 558 (Sub-No. 10), filed July 25, 2007 (noting that the consensus railroad cost of capital among financial firms was

repeated findings that BNSF was “revenue inadequate” when he decided to acquire the railroad, and it is the height of irony – and yet another demonstration of how flawed the Board’s revenue adequacy standards are – that BNSF will look poorer (more revenue inadequate) after being acquired by one of the world’s most astute investors in a transaction where his company agreed to pay a \$8.1 billion premium to acquire the carrier.

The Board can take one step in this proceeding to address the fundamental flaws in its revenue adequacy standards: not include the Berkshire acquisition premium in its calculation of BNSF’s revenue adequacy rate base.

### **CONCLUSION**

For the reasons set forth above, Coal Shippers/NARUC respectfully request that the Board issue a declaratory order excluding the acquisition premium from BNSF’s URCS, starting in 2010, and excluding the premium in calculating BNSF’s net investment base for revenue adequacy purposes, starting in the Board’s 2010 revenue adequacy determination.

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approximately 9.5% versus the 13.8% proposed by the AAR under the Board’s standards, and also noting that the financial community saw little risk in investing in railroads).

Respectfully submitted,

WESTERN COAL TRAFFIC LEAGUE  
AMERICAN PUBLIC POWER ASSOCIATION  
EDISON ELECTRIC INSTITUTE  
NATIONAL ASSOCIATION OF REGULATORY  
UTILITY COMMISSIONERS  
NATIONAL RURAL ELECTRIC  
COOPERATIVE ASSOCIATION  
WESTERN FUELS ASSOCIATION, INC., AND  
BASIN ELECTRIC POWER COOPERATIVE, INC.

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Dated: October 28, 2011

By: William L. Slover

John H. LeSeur

Peter A. Pfohl

Daniel M. Jaffe

1224 Seventeenth Street, N.W.

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(202) 347-7170

Their Attorneys

## **CERTIFICATE OF SERVICE**

I hereby certify that this 28th day of October, 2011, I have caused copies of the forgoing to be served via first-class mail, postage prepaid upon all parties of record to this case.



Peter A. Pfohl





**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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Finance Docket No. 35506

Petition of the Western Coal Traffic League for a  
Declaratory Order

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**VERIFIED STATEMENT OF  
CHARLES D. GRAY**

**EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF  
REGULATORY UTILITY COMMISSIONERS**

My name is Charles D. Gray. I am Executive Director of the National Association of Regulatory Utility Commissioners (NARUC), a position that I have held since 1999. Prior to my appointment as Executive Director, I served as General Counsel for NARUC. NARUC is consistently recognized by Congress, the courts, and many federal agencies (including the Federal Energy Regulatory Commission) as the representative of the collective interests of State utility commissions. NARUC members in the 50 States, the District of Columbia, Puerto Rico, and the Virgin Islands have the obligation under State law to ensure the establishment and maintenance of such utility services as may be required by the public convenience and necessity, and to ensure such services are provided at just and reasonable rates.

The purpose of this statement is to urge the Surface Transportation Board (STB) to use its substantial authority over railroads and rates to exclude from the regulatory rate base the significant "acquisition premium" paid by Berkshire Hathaway Inc. (Berkshire) to acquire BNSF Railway Company (BNSF). In particular, this premium should be excluded from the rates of any regulated shipper and from the STB's costing system used

to develop variable costs of service for individual movements, and should not be allowed to be used as part of the STB's annual revenue adequacy determination for BNSF.

A core statutory mission of NARUC member utility commissions is to ensure that consumers obtain service from regulated public utilities at reasonable and just rates. Today, States (and public utility commissions) no longer have jurisdictional authority to regulate railroad rates or oversee railroad mergers or acquisitions, or the impacts of those acquisitions. Instead, Congress has provided that the economic regulation of railroads resides under the exclusive authority and control of the STB. NARUC member utility commissions rely on the STB to stand in their place as the sole protector of the public interest on railroad regulatory ratemaking and related matters. This is a very important issue as these are, in effect, costs that are ultimately borne by utility ratepaying consumers in their monthly electric bills as pass through costs, as well as by farmers, manufacturers, and other businesses that rely on BNSF freight rail service and have no effective competition.

I respectfully submit that there should be no hesitation here by the STB to block the estimated substantial \$8,100,000,000 write-up in BNSF's net investment base from being included in the Board's costing programs. No other regulatory body to my knowledge would permit these ratepayer pass-throughs in similar circumstances.

Together with the American Public Power Association (APPA), the Edison Electric Institute (EEI), and the National Rural Electric Cooperative Association (NRECA), NARUC wrote to the STB on this matter in May, 2011. (*See* letter attached to this statement). In our letter, we urged the STB to exclude this acquisition premium from the rate base, stating "[i]n the regulated portions of the electric utility industry, such premiums are excluded by general rule from being included in the rate base." We also cited the recent *Study of Rural Transportation Issues* (Apr. 2010 at 263) by the U.S. Department of Agriculture (USDA) and the U.S. Department of Transportation, questioning the STB's prior practice in this area and proclaiming that the railroads are the only regulated industry that has been allowed to add merger premiums into its rate base.

The impacts of this issue go well beyond utilities. Ten United States Senators have written to the STB to express their concerns over the adverse impacts on all captive shippers should the premium be allowed to be included in BNSF's rate base. Likewise, the USDA expressed its concerns a recent letter to the STB:

The [acquisition premium] unfavorably impact[s] rail rates paid by utilities serving rural areas, resulting in higher rates for electricity than would otherwise be the case. These higher electricity rates increase farm production costs and reduce the economic vitality of rural areas. Finally, [acquisition premiums] result in higher rail rates for grain and oilseed shippers, particularly for those distant from barge transportation and are thereby most reliant upon rail services.

USDA letter to STB (June 20, 2011).

Whatever justifications may have been provided in the past at the STB to allow certain railroad merger premiums to be included in the rate base (e.g., potential merger "synergies"), those justifications do not exist here, where BNSF's costs, operations, management, and all aspects of its railroad business remain unchanged post Berkshire acquisition. The only thing that appears to have changed as a result of the transaction is that Berkshire has paid a significant premium to acquire BNSF, and it wants its captive shippers to pay more to cover that premium. But Warren Buffet has declared that Berkshire has already obtained ample returns on its BNSF investment, even without the inclusion of the acquisition premium in BNSF's rate base:

The highlight of 2010 was our acquisition of Burlington Northern Santa Fe, a purchase that's working out even better than I expected. It now appears that owning this railroad will increase Berkshire's "normal" earning power by nearly 40% pre-tax and by well over 30% after-tax. Making this purchase increased our share count by 6% and used \$22 billion of cash. Since we've quickly replenished the cash, the economics of this transaction have turned out very well.

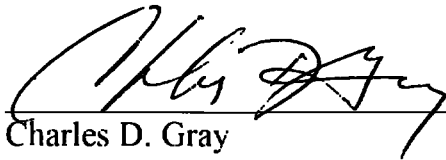
Berkshire Hathaway Inc., 2010 Chairman's Letter to Shareholders (Feb. 26, 2011).

Even if BNSF could somehow show a legitimate financial need for acquisition premium pass-throughs in this instance, that should not be a sufficient basis for forcing captive shippers to pay more for service. To do so would be an affront to fundamental principles of public utility regulation and just and reasonable rates. I respectfully submit that the statutory ratemaking responsibilities of the STB should not be allowed to be stymied by any railroad hoping to achieve higher rates of return, and maximize the financial return for its investors, at the expense of captive shippers.

In conclusion, I repeat the request NARUC, APPA, EEL, and NRECA made in our May 2011 joint letter to the STB: “[w]e urge the STB to implement the approach of all other regulatory bodies and refuse to apply an acquisition premium for regulatory costing purposes, and to use all of its powers to ensure that rail consumers, and ultimately electric utility ratepayers, are protected against the prospect of any such acquisition premium pass-throughs.”

## VERIFICATION

I, Charles D. Gray, verify that I have read the foregoing Statement, know the contents thereof, and that the same are true as stated to the best of my knowledge, information and belief. Further, I certify that I am qualified and authorized to file this statement.



Charles D. Gray

Executed on October 25, 2011



**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB Finance Docket No. 35506**

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**Verified Statement of Dr. John W. Wilson**

**On behalf of**

**The Western Coal Traffic League**

**American Public Power Association**

**Edison Electric Institute**

**National Association of Regulatory Utility Commissioners**

**and**

**National Rural Electric Cooperative Association**



**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB Finance Docket No. 35506**

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**Verified Statement of Dr. John W. Wilson**

**QUALIFICATIONS**

My name is John W. Wilson. I am President of J.W. Wilson & Associates, Inc. Our offices are at 1601 North Kent Street, Suite 1104, Arlington, Virginia, 22209. I hold a Ph.D. in Economics from Cornell University. I have also received a B.S. degree with senior honors and a Masters Degree in Economics from the University of Wisconsin. My major fields of study were industrial organization and public regulation of business, and my doctoral dissertation was a study of utility pricing and regulation.

After completing my graduate education, I was an assistant professor of economics at the United States Military Academy, West Point, New York. In that capacity, I taught courses in economics and government at the introductory and intermediate levels. While at West Point, I also served as an economic consultant to the Antitrust Division of the United States Department of Justice.

After leaving West Point, I was employed by the Federal Power Commission (FPC, now the Federal Energy Regulatory Commission (FERC)), first as a staff economist and then as

Chief of the FPC's Division of Economic Studies. In that capacity, I was involved in regulatory matters involving most phases of FPC regulation of electric utilities and the natural gas industry, including many cases involving rate base valuation. Since 1973, I have been employed as an economic consultant by various clients including federal, state and local governments, private enterprise and nonprofit organizations. My work has included a wide range of issues concerning public utility regulation, energy policy, antitrust matters, economic and financial analysis, and insurance rate regulation.

I have authored a variety of articles and monographs dealing with utility regulation, as well as utility mergers and acquisitions. I have consulted on regulatory, financial and competitive market matters with the Federal Communications Commission, the National Academy of Sciences, the Ford Foundation, the National Regulatory Research Institute, the Electric Power Research Institute, the U.S. Department of Justice, the Commerce Department, the Department of the Interior, the Federal Trade Commission, the Department of Energy, the Small Business Administration, the Internal Revenue Service, the Department of Defense, the Tennessee Valley Authority, the Federal Energy Administration, and numerous state and provincial agencies and legislative bodies in the United States and Canada.

Previously, I was a member of the Economics Committee of the U.S. Water Resources Council, the FPC Coordinating Representative for the Task Force on Future Financial Requirements for the National Power Survey, and the Advisory Committee to the National Association of Insurance Commissioners (NAIC) Task Force on Profitability and Investment Income, and the NAIC's Advisory Committee on Nuclear Risks. In addition, I

have testified on numerous occasions as an expert on financial and regulatory matters, and I have participated as a speaker, panelist, or moderator in many professional conferences and programs dealing with business regulation, financial issues, mergers and acquisitions, asset valuation, economic policy and antitrust matters. I am a member of the American Economic Association and an associate member of the American Bar Association and the ABA's Antitrust, Insurance and Regulatory Law Sections.

I have presented testimony on utility asset valuation and rate base on many occasions. I have testified in regulatory proceedings in most states as well as in federal and state court proceedings. I have also testified before Committees of the U.S. Senate and House of Representatives on numerous occasions. A copy of my full curriculum vitae is attached as Exhibit A.

### **SUMMARY**

My testimony in this case is presented on behalf of the Western Coal Traffic League, the American Public Power Association, the Edison Electric Institute, the National Association of Regulatory Utility Commissioners, and the National Rural Electric Cooperative Association. I address below generally matters of rate base valuation under rate regulation in accordance with established public utility regulation principles and, in particular, the issue of acquisition premiums that can occur when businesses or business property assets are acquired in market transactions. In this case, the BNSF Railway Company ("BNSF") has been acquired by Berkshire Hathaway Inc. ("Berkshire") for \$42.9 billion. As a result of this transaction, and to account for its significant investment price, BNSF has written up

its net investment base by an estimated \$8.1 billion. The issue is whether this \$8.1 billion “acquisition premium” should be included in BNSF’s ongoing net investment base (or “rate base”), for ratemaking and related costing purposes under the STB’s Uniform Railroad Costing System, which would entitle Berkshire to regulated ratepayer compensation for the acquisition premium.

As I discuss below, consistent with sound principles of public utility regulation, and the uniform application of these principles by all other regulatory bodies with similar responsibilities (in the context of both fully and partially regulated industries), the \$8.1 billion acquisition premium should be wholly excluded from BNSF’s rate base for ratemaking and other similar regulatory purposes. The inclusion of the \$8.1 billion acquisition premium in BNSF’s ongoing rate base would be inconsistent with sound and widely accepted regulatory practice; it would result in double charging ratepayers for the inflation of BNSF’s market value over time; and it would force railroad users to compensate BNSF for funds that were not an investment in railroad facilities or a contribution to rail service. Further, the transaction produces no public benefits (e.g., cost reductions, efficiencies, synergies etc.), and thus the exception to the general rule of excluding acquisition premiums from the rate base cannot be met. I am aware of no other instance under similar circumstances in the regulated utility context where regulators have authorized the pass through of the premium to the rate base and ratepayers, and I believe that to do otherwise would be contrary to the fundamental duty of regulators to ensure just and reasonable rates.

## **I.**

### **WHAT ARE ACQUISITION PREMIUMS?**

Acquisition premiums commonly occur in corporate takeovers and in the sale of pre-existing business property. For regulatory purposes, generally they are the difference between the pre-transaction value of net assets and the post-transaction value of net assets based on the price the acquiring firm pays to buy them.

Acquisition premiums have always been an especially important issue in cases involving the sale of public utility property – whether the sale of entire public utility companies or of a particular utility plant. That is so because of our system of public utility regulation under which the corporate owners of public utility property are typically entitled to charge rates that earn a fair rate of return on (and recover the depreciation of) utility rate base. Public utility rate base is primarily comprised of the investment in public utility property. Thus, the valuation of public utility property (i.e., public utility rate base) is central to the regulatory determination of utility company rates and income.

## **II.**

### **THE HISTORICAL BASIS FOR EXCLUSION OF ACQUISITION PREMIUMS FROM THE RATE BASE**

For more than a half a century, regulators have uniformly excluded acquisition premiums from the rate base for ratemaking and related purposes as a general rule. The key reason for excluding acquisition premiums from the rate base in federal and state regulatory practice is basic fairness to the ratepayer under principles of just and reasonable rates.

## A. RATE BASE VALUATION

In the early days of public utility regulation (generally until the Supreme Court's famous *Hope Natural Gas* case in 1944<sup>1</sup>) utility rate base was quantified in terms of the "fair value" of the plant investment that was used to provide public utility service.<sup>2</sup> Disputes over what constituted "fair value" and how to estimate it dominated public utility regulation for half a century, with little consensus and much criticism of the process. According to Justice Brandeis, in taking on the judicial task of determining the "fair value" of utility rate base "courts have been projected into the most speculative undertaking imposed upon them in the entire history of English jurisprudence..."<sup>3</sup>

Leading economic scholars of the time concluded that regulatory commission determinations of "fair value" rate base produced "a final value figure which bears no derivative relation to any figure in evidence and no ascertainable relation to any functional purpose of ratemaking.... The peculiar contribution of the 'fair value' method to rate regulation is indecision and confusion."<sup>4</sup> There is little wonder at this frustration over the regulatory process of fair value rate base determination. Because expected profits determine business property value, regulators were actually determining utility property value by setting profit levels and rates. Therefore, it was circular and illogical to attempt to determine rate base fair value as the basis for setting rates and profit levels. Ultimately it

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<sup>1</sup> *Federal Power Comm'n v Hope Natural Gas Co.*, 320 U.S. 591 (1944).

<sup>2</sup> The *fair value* methodology emerged from the Supreme Court's decision in *Smyth v. Ames* where the Court ruled that "The basis of all calculations as to the reasonableness of rates ... must be the fair value of the property being used." *Smyth v. Ames*, 169 U.S. 466, 546 (1898).

<sup>3</sup> Dissenting opinion (supported by Justices Brandeis and Cardozo) in *West v. Chesapeake & Potomac Tel Co.* 295 U.S. 662, 689 (1935).

<sup>4</sup> Ben W. Lewis, "Public Utilities." (L.S. Lyon and V. Abramson eds.), *Government and Economic Life* (Washington, D.C.: The Brookings Institution, 1940), Vol. II, p. 692-93.

was recognized that the value of public utility property is the end result of the regulatory process; not the starting point.

When “fair value” was cast aside in the 1940s in favor of a fair “end result” standard as directed by *Hope* (i.e., fair or just compensation for utility investors), both federal and state regulators moved to the adoption of “original cost” as the appropriate measure of rate base. Original cost offered little ambiguity and great administrative simplicity. It was an easily verifiable accounting measure that was readily available from utility company books and records, requiring little complicated analysis or the exercise of judgment. The major remaining potential complication occurred in situations where utility plant or utility companies were sold. After such acquisitions, the question was whether the relevant “original cost” to be used for ratemaking was the cost to the acquiring firm or the historic original cost of the seller.

## **B. ACQUISITION PREMIUMS IN RATE BASE**

The issue of including acquisition premiums in rate base had been a major point of dispute in the 1920s and 1930s as utility plant was often sold between utility companies and even between affiliates within holding company corporate structures at prices that escalated over time. Under the “fair value” rate base standard that prevailed at that time, regulators often considered market transaction prices in arriving at fair value. This encouraged the sale of utility property, and in some cases its resale, at ever escalating prices that allowed for rate base inflation, resulting in progressively higher utility rates over time for consumers. As a consequence, the mere selling of property could inflate utility property “value” and raise

utility rates and profits. Such utility asset sales, especially when they occurred between affiliates in a holding company, were simply financial transactions with no service improvements, economies or betterments – all that transpired was a bookkeeping accounting entry.

The widespread abuse of this practice and the resulting rate base manipulation, especially between affiliates within public utility holding companies, was one of the important motivations behind Congressional passage in 1935 of the Public Utility Holding Company Act as Title I of the Federal Power Act.<sup>5</sup> This landmark legislation indicated that the property and plant in an electric utility's "Electric plant in service" account and in its subaccounts should reflect original cost and that original cost should be identified as cost to the first owner placing the property in public utility use. Thereafter, both federal and state regulatory commissions embodied these original cost principles in uniform systems of account. These accounts were put into effect by the Federal Communications Commission for interstate telephone companies in 1936 and by the FPC for interstate electric utilities in 1937 and for interstate natural gas pipeline companies in 1940. Most state commissions adopted similar original cost accounting for intrastate regulatory purposes shortly thereafter. Because the regulatory adoption of these original cost principles occurred shortly before the Supreme Court's *Hope Natural Gas* decision, it enhanced the rapid implementation of original cost<sup>6</sup> rate base valuation for ratemaking purposes. Today and

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<sup>5</sup> 15 U.S.C.A. § 79, 49 Stat. 803 (1935). Title I. Public Utility Holding Company Act of Public Utility Act, 1935.

<sup>6</sup> As for the question, "Who's original cost?", regulators were ultimately unanimous in finding that original cost means the first original cost of an asset when first devoted to public utility service, rather than a transfer price to a new property owner. Whereas *actual cost* in another accounting context may mean cost to the current owner of the property, *original cost* in regulatory terms means the "first" original cost of the property acquired by a public utility. Public utility property that is sold and acquired by a new owner is thus recorded



for more than half a century, acquisition premiums paid for public utility property, the difference between the current owner's acquisition price and the property's original cost when first dedicated to public use, are generally excluded from the utility rate base. The fundamental reason for this rate base exclusion of acquisition premiums is the public policy goal of establishing just and reasonable rates. Public utility regulators are therefore obligated to ensure that utility property owners are allowed to charge rates that provide them with a reasonable opportunity to earn a fair profit on their investments dedicated to public service and, at the same time, to assure that utility ratepayers are not subjected to paying rates that produce excessive rates of return – i.e., excessive profits in relation to the assets devoted to their utility service. It follows that when utilities or utility property is sold, the cost entitled to earn a fair return is the cost incurred for the public benefit – not the price paid to buy out an earlier owner's financial interests.

To be clear, and as further explained below, this is not just a matter of addressing the above-referenced problem of circularity (e.g., the practice of companies paying excessive amounts for utility plant in the hopes of extracting ever increasing returns), which is only one of many forms of unfairness to ratepayers. Regardless of the motivations of the purchaser, or whether the purchase price is *bona fide*, allowing the acquisition premium in

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in rate base at the cost to the preceding owner who first devoted it to public utility service. Specifically, the FPC defined *original cost* as "... the cost of such property to the person first devoting it to public service." Federal Power Commission, *Uniform System of Accounts Prescribed for Public Utilities and Licensees*, effective January 1, 1937, definition 29, p.6. The same FPC definition applies to natural gas plants. The Federal Communications Commission states that "'Original cost' or 'cost' as applied to telephone plant, franchises, patent rights and right of way, means the actual money cost of (or the current money value of any consideration other than money exchanged for) property at the time when it was first dedicated to public use, whether by the accounting company or by predecessors." Federal Communications Commission, *Uniform System of Accounts, Class A and Class B Telephone Companies*, effective January 1, 1936. Section 31 01-3(x).

the rate base would unfairly result in double compensation for inflation producing unnecessary windfalls, and unfairly compensating investors where they are not devoting capital to the public service.<sup>7</sup> Additionally, even in partially deregulated markets, total circularity is not necessary in order for ratemaking to be tainted by an acquisition premium, because, even allowing a portion of a regulated business to be affected will overcharge the effected payers of regulated rates and unfairly increase the value of the regulated portion of the business.

### **III.**

#### **OTHER AGENCIES' TREATMENT**

Universally, no other agencies as a general rule allow the inclusion of acquisition premiums in the rate base (the “benefits” exception is explained below). On this point, the United States Department of Agriculture and the United States Department of Transportation have recently declared that “the railroad industry and the STB are the only industry and regulator that . . . add merger premiums into the rate base.”<sup>8</sup> Other regulators have soundly recognized the dangers of relying on acquisition costs that result in write-ups of assets in connection with cost-driven rate regulation. Examples of similarly situated entities that are precluded by general rule from including purchase premiums in the rate base include:

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<sup>7</sup> See *The Acquisition Premium. A U-Turn in Merger Policy?*, Fortnightly, May 15, 1999 (Vol. 137, No. 10).

<sup>8</sup> *Study of Rural Transportation Issues*, United States Department of Agriculture and United States Department of Transportation (Apr. 2010), p. 263.

- Electric Utilities<sup>9</sup> (including electric transmission line purchases<sup>10</sup>)
- Gas Pipelines<sup>11</sup>
- Oil Pipelines<sup>12</sup>
- Telecommunications,<sup>13</sup>
- Cable Television,<sup>14</sup> and
- Generally, Utilities/Franchises Subject to State and Local Control (e.g., Electric Utilities, Water Utilities, Wastewater Utilities, Natural Gas Utilities, Other Local Franchises).<sup>15</sup>

Regulatory policy in these industries prudently holds that acquisition premiums must be excluded from the rate base for basic fairness purposes and for the further reasons set forth herein. This rule encompasses the principle that “utility customers should not pay on an amount in excess of the cost when property was originally devoted to public service, since any excess represented only a change in ownership without any increase in the service function to utility ratcpayers.”<sup>16</sup> These other agencies’ treatment is consistent with general regulatory philosophy favoring use of original cost for ratemaking purposes. It is also

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<sup>9</sup> See, e.g., *Duke Energy Moss Landing LLC et al.*, 83 FERC ¶ 61318, 62303-05 (1998); *Entergy Servs., Inc. and Gulf States Utils. Co.*, 65 FERC ¶ 61332, 62537-38 (1993).

<sup>10</sup> See, e.g., *Montana Power Co. v. FERC*, 599 F.2d 295 (9<sup>th</sup> Cir. 1979); *Startrans IO, L.L.C.*, 130 FERC ¶ 61209 (2010).

<sup>11</sup> See, e.g., *Missouri Pub. Serv. Comm’n v. FERC*, No. 09-1121, slip op. pp. 9-14 (D.C. Cir. Feb. 19, 2010); *Transcon. Gas Pipe Line Corp. v. FERC*, 652 F.2d 179, 187 (1981); *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61260, 61937-39 (2002).

<sup>12</sup> See, e.g., *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1528 (D.C. Cir. 1984).

<sup>13</sup> See, e.g., *In re Am. Tel. and Tel. Co., the Assoc. Bell Sys. Cos.*, 67 F.C.C.2d 1429 (1978).

<sup>14</sup> See, e.g., *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, 11 F.C.C.R. 2220, 2238-47 (1996).

<sup>15</sup> See, e.g., *50-State Survey of Acquisition Adjustment*, Nat. Ass’n of Water Cos. (located at <http://www.nawc.org/policy-issues/state-reg-resources/acquisition-adjustment.html>): I. Goodman, *The Process of Ratemaking* (1988), pp. 733-34; 762-63; 775-99.

<sup>16</sup> Accounting for Public Utilities, §4.04[2] (Matthew Bender & Co., Inc. 2011).

consistent with Supreme Court precedent that has recognized the dangers of allowing regulated rates to be determined on the basis of “fair value” where the regulated entity gets to control the measure of that value.<sup>17</sup>

#### IV.

#### **PREVENTING UNFAIR INVESTOR WINDFALLS**

##### **A. COMPENSATION FOR INFLATION**

This fundamental regulatory principle has not been without challenges over time. The primary challenge has been that when the rate of inflation exceeds the rate of technological advancement over time, the value of non-utility business property tends to increase as its replacement cost increases, and the owners of such property enjoy the value of property appreciation and corresponding higher prices for the output of their plant investment. In other words, in such circumstances investors are compensated for inflation. Some critics of utility original cost rate base have questioned why, if such compensation for property value inflation is appropriate for unregulated businesses, corresponding compensation (i.e., allowing acquisition premiums to be included in rate base) is inappropriate for public utilities, or for public utilities whose assets and service are only partially regulated (*e.g.*, railroads).

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<sup>17</sup> See *FPC v. Hope Natural Gas, Co.*, 320 U.S. 591, 601 (1944) (“[t]he heart of the matter is that rates cannot be made to depend on ‘fair value’ when the value of the going enterprise depends on earnings under whatever rates may be anticipated”).

## 1. Inflation Compensation for Property in Regulated Markets.

The answer to this question lies in the design and process of public utility ratemaking in which value and return are interrelated concepts. In traditional utility regulation, the allowed return earned by public utility property owners is determined by the amount of the utility rate base and by the rate of return allowed to be earned on that rate base. Earnings are equal to rate base multiplied by the allowed rate of return (“ROR”).<sup>18</sup> Thus, if rate base is \$1 million and the allowed ROR is 10 percent, allowed annual earnings are \$100,000. While determining fair ROR is almost always vigorously contested in utility rate cases, the regulatory objective is to establish an allowed ROR that fairly compensates investors (and charges consumers) for the current cost of capital. The cost of capital is determined in competitive financial markets and reflects current capital scarcity as well as the currently perceived risk of inflation. Inflation risk is a most important element of the cost of capital and fair ROR because investors who commit funds to long-lived utility capital investments require more compensation when the risk of inflation is great than when inflation risk is small.

If the allowed ROR is not at least equal to the rate of inflation, investors will earn a negative *real* ROR over time. In order to earn a positive *real* ROR, the nominally allowed ROR must exceed the rate of inflation. Therefore, in order to fairly compensate investors, regulatory commissions allow *nominal* RORs that include both compensation for inflation risk and a real return. In other words, a 10 percent allowed ROR may be comprised of 4

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<sup>18</sup> I recognize that ROR is not the ratemaking standard employed at the STB, but these same general principles apply in the establishment of rates (or the governing jurisdictional threshold) at the STB under the Uniform Rail Costing System.

percent for inflation risk plus a 6 percent real ROR. Investors in utility property are therefore compensated for inflation through the ratemaking process. To allow further compensation for inflation by permitting acquisition premiums to be included in future rate base valuation would constitute double compensation for inflation by allowing utilities to capture the cost of inflation twice – once on an expected basis by including the risk of inflation in the ROR component of rates and again by including inflated property value in an acquisition premium adder to rate base. This, in turn, would require utility service consumers to pay rates that produce excessive and unreasonable RORs and investment cost recovery over time.

## **2. Inflation Compensation for Property in Competitive Markets.**

In contrast to ratemaking practice in regulated markets, in competitive markets investors are not compensated for inflation risks in advance. On the contrary, competition does not allow such “double dipping.” Unregulated firms know that their assets will appreciate with inflation, and competition forces them to accept a correspondingly lower rate of current income. Of course, expected total income for these firms (current income plus asset appreciation) covers the competitive firm’s total cost of capital, including the risk of inflation. Current earnings are only part of investor compensation in unregulated markets. Additional compensation is reflected in the appreciation of their business ownership interest (“capital gains”) and in resale prices when property or business ownership shares are sold. By the same token, double compensation would occur if, as advocated here by BNSF, a current cost of capital ROR were applied to a regulated rate base including acquisition premium.

### **3. Inflation Compensation for Property Operating in Both Competitive and Regulated Markets.**

These same principles apply when regulated utility service is provided by a conglomerate business enterprise that supplies products and services in both regulated and unregulated markets. In such cases the regulated portion of the enterprise earns an allowed return equal to the current cost of capital inclusive of inflation risk. Owners of regulated utility assets are compensated for inflation risk through regulated rates as described above.<sup>19</sup> In contrast, the unregulated portion of the enterprise is disciplined by competition and earns only a *real* return currently, but subsequently benefits from capital gains and appreciated business value over time. When such conglomerate enterprises are sold or when they divest unregulated assets, the sale price will reflect an acquisition premium related to the expected future unregulated earnings attributable to the current market value (including inflation-induced appreciation) of the unregulated business property.

#### **B. NO CHANGE IN QUALITY AND COST OF SERVICE**

Public utility regulators have consistently held that a mere change in ownership without any changes in basic services should not result in an increase in rates no matter whether the purchase price is *bona fide* or not:

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<sup>19</sup> This is the case for regulated railroad rates as well as public utility rates. In the *Staggers Act*, Congress directed the ICC to adopt standards to determine whether carriers were "revenue adequate." See 49 U.S.C. § 10704(a)(2)-(3). The ICC then proceeded to adopt implementing standards in a series of decisions. See *Standards for Railroad Revenue Adequacy*, 364 I.C.C. 803 (1981), *Standards for Railroad Revenue Adequacy*, 3 I.C.C. 2d 261 (1986), and *Supplemental Reporting of Consolidated Information for Revenue Adequacy Purposes*, 5 I.C.C. 2d 65 (1988). Pursuant to those procedures, a railroad was considered revenue adequate under 49 U.S.C. § 10704(a) if it achieves a rate of return on net investment equal to at least the *current cost of capital* for the railroad industry. Under this standard, the I.C.C. and the Surface Transportation Board ("STB") have always allowed railroads to earn a nominal ROR equal to the current cost of capital, inclusive of inflation risk.

If the quality and cost of service will be substantially identical, irrespective of whether the utility is autonomous or part of an integrated system, it is inequitable to charge the consumer with values recognized solely because of the transfer.<sup>20</sup>

This proposition is so well-settled in public utility law, that the issue does not frequently arise, because the affected utility will usually stipulate to the regulator that it will not attempt to pass through any acquisition premium to the ratepayer. Where a transaction is an acquisition, rather than a merger, without any change in basic management, operations, or service, there is no possibility of public benefits, and thus no legitimate justification for inclusion of the premium in the rate base. Indeed, when Berkshire Hathaway acquired PacifiCorp (through a subsidiary, MidAmerican Energy Holdings Company (MEHC)) in 2006 Berkshire voluntarily stipulated that it would not, and could not, pass the merger premium through to the rate base under established principles of public utility regulation:

Q: Is the distinction between a merger and an acquisition that you previously discussed relevant to MEHC's position regarding the treatment of the acquisition premium?

A: The distinction between a merger and an acquisition is critical with respect to the expectations for regulatory treatment of the acquisition premium. Merged utilities may expect to recover the acquisition premium if they are able to demonstrate cost reductions or other benefits to customers exceeding the cost to customers of providing a return on the acquisition premium. This potential for a return on the premium may or may not impact the size of the premium that the merging utilities are willing to negotiate.

In contrast, because MEHC transactions are acquisitions and because MEHC will not claim cost reductions that it does not believe it can deliver, MEHC recognizes that it is unlikely that it

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<sup>20</sup> *Ratemaking: Acquisition Adjustments Not Chargeable to Operating Expenses*, 55 Colum. L. Rev. 244 (Feb. 1955) p. 246-47 (quoting *Niagara Falls Power Co. v. FPC*, 137 F.2d 787, 793 (2d Cir. 1943)).



will ever recover the acquisition premium. Accordingly, MEHC is reluctant to negotiate a price for an acquisition that is significantly in excess of book value. For example, the prices negotiated for both MEC and PacifiCorp were approximately 130% of book value.

MEHC recognizes the inability to earn a regulated return on the acquisition premium is simply the price paid by shareholders for the opportunity to earn a regulated return on the remainder – the book value or original cost (less depreciation) used for ratemaking purposes. MEHC accepts that regulatory treatment as long as the regulators apply original cost ratemaking fairly and equitably.<sup>21</sup>

Berkshire Hathaway's acquisition of BNSF was an acquisition, not a merger between two railroads. To my knowledge, neither Berkshire nor BNSF here is claiming any possible benefits to the ratepayer (c.g., better service quality, reduced service costs, etc.) (the "benefits" exception is explained further below) and they cannot, as this is a straightforward acquisition without any changes in operations, service, or costs. Berkshire clearly knows the settled law in such instances on acquisition premiums, as demonstrated by the above stipulation in its PacifiCorp acquisition case, yet BNSF still is attempting here to pass through to the rate base a substantial acquisition premium. To allow such a pass-through here would result in inconsistent and absurd results and be in violation of a central tenant of public utility regulation.

### **C. VALUATION SPIRAL**

As briefly discussed above, a further reason why public utility regulators have generally refused to include acquisition premiums in rate base relates to the unjustifiable spiraling

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<sup>21</sup> Washington Utilities and Transportation Commission. Docket No. UE-051090. *In re. the Joint Application of MidAmerican Energy Holdings Co. and PacifiCorp for an Order Authorizing Proposed Transaction*. Rebuttal Testimony of Brent L. Gale (dated Dec.2005), p. 25.

effect (or circularity) that such inclusion would likely have on rates and asset values.<sup>22</sup> The market value of business assets in both regulated and unregulated industries is essentially determined by the income that the assets are expected to produce. Consequently, if a regulated utility asset is expected to produce, say, \$1 million of income per year for twenty years and utility investors have a discount rate (i.e., cost of capital) of 10 percent, the market value of the asset is likely to be approximately \$8.5 million:

$$\sum 1,000,000/1.10, \dots, 1,000,000/1.10^{20} = 8,513,564$$

If this asset had a net original cost book value of \$6 million, its sale for \$8.5 million would result in an acquisition premium of about \$2.5 million or about 42 percent. If this premium were added to rate base and earned the same percentage return as the original \$6 million asset, expected earnings would rise from \$1,000,000 to about \$1,420,000. If then, this same asset with a higher expected twenty year income stream were to be sold to corresponding investors with the same discount rate, the market value would increase to about \$12 million:

$$\sum 1,420,000/1.10, \dots, 1,420,000/1.10^{20} = 12,089,260$$

This process of rate base escalation could continue to spiral as long as each new acquisition premium is added to rate base. That is, just as income rose by 42 percent when the rate base value of the asset increased from \$6 million to \$8.5 million, a further rate

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<sup>22</sup> As noted below, the importance of this point may be less in this case, due to the preponderance of rail shippers whose rates are not regulated, than it is in cases involving public utilities whose rates are largely regulated.

base value increase to \$12 million would imply a further rise in expected annual income to \$2 million and therefore a further increase in the asset's market value, and so on and so on.

While the valuation spiral that would occur by including acquisition premiums in utility rate base is compelling reason enough to reject such inclusion in most regulated utility industries, it has not been viewed as equally restrictive by the ICC and STB in the case of railroad acquisitions. Because most rail rates are not regulated, paying an excessive amount for rail assets would permit only fractional recapture through rate base inflation since most shippers' rates are determined by market forces and not by an allowed rate of return on rate base. Thus, the STB has stated:

Given that very few rail shippers are captive shippers whose rates ever require regulatory intervention, paying too much for property in hopes of extracting increased rents would be a self-defeating strategy in the rail industry.<sup>23</sup>

While the ability to include acquisition premiums in rate base would therefore be less likely to cause spiraling asset acquisition *prices* in industries where most consumers are protected by competition, it would, nonetheless, still cause an unwarranted increase in the *value* of the acquired company, creating a circularity problem. It would also result in unwarranted rate base and rail rate increases for captive shippers paying regulated rates. In other words, there does not need to be *total* circularity in order for ratemaking to be tainted by an acquisition premium. This is not about incentives to pay inflated prices, or whether Berkshire was incented to pay more in the hopes of achieving higher rates of return. Berkshire's incentives or motivations should not matter. It is enough that a portion of a

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<sup>23</sup> Quoted in *Erie-Niagara Rail Steering Comm. et al. v. Surface Transp. Bd.*, 247 F.3d 437 (2<sup>nd</sup> Cir. 2001). See also *Ass'n of Am. R.R.s v. ICC*, 978 F.2d 737, 741-42 (holding *Hope* inapplicable on similar grounds).

carrier's traffic is affected (its captive traffic), because to allow the premium pass through would be unreasonable and result in excessive rates for those consumers whose rates are rate base regulated because of an inflated asset value.

## V.

### ACQUISITION PREMIUM PRINCIPLES APPLIED

#### A. AN ILLUSTRATION

The most venerable and widely cited academic authority on utility rate base, the late James C. Bonbright, underscores these principles in his writings.<sup>24</sup> As Bonbright states, "'Original Cost,' in public utility accounting, has now become a term of art. It means the cost of an asset when first devoted to the public service rather than the cost to a transferee company. ... 'Investment' refers to the capital funds contributed by the company to the public service as distinct from the current values of assets acquired by these funds."<sup>25</sup>

Bonbright goes on to present and critique a specific example, with similarities to the present case, as follows:

Let us assume, as we must under the ratemaking standard now before us, that the rate base of a company which seeks an increase in its rates is to be set at the depreciated original costs of its properties ... regardless of the question whether or not these costs reflect the contemporary valuation of the assets. But let us also

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<sup>24</sup> See James C. Bonbright, *Principles of Public Utility Rates* (New York: Columbia University Press, 1961) and James C. Bonbright et al., *Principles of Public Utility Rates, Second Edition* (Arlington, Virginia: Public Utility Reports, Inc., 1988).

<sup>25</sup> Bonbright et al., *Id.*, at 237-238.

assume that the properties of the present company were constructed at a cost of \$6 billion, and had accumulated depreciation of \$1 billion. Furthermore, the properties were later acquired by purchase from the original company in an arm's length transaction for a cash price of \$8 billion – a price paid based on the then anticipated rate levels and earnings.

Under these assumptions, which original-cost figure should govern the rate base – the \$5 billion depreciated construction cost, or the \$8 billion acquisition cost (citation omitted). A mere resort to the definition of “actual cost” will not supply the answer, nor would the substitution of terms such as “historical cost” or “original cost” (in its traditional non-technical sense). For the \$6 billion construction cost and the \$8 billion acquisition cost are equally actual, equally historical, and equally original (to the one company or to the other).

... We may add the further assumption that viewed as a business transaction, the price paid for the properties by the present company was not extravagant in the light of the generous earnings that might have been anticipated under the influence of the then prevailing rules and practices of rate regulation. This being the situation, what are the merits of a contention by the present company that even under an original-cost rule of ratemaking, it must be permitted to enjoy a fair rate of return on the cost incurred by it rather than on the cost to the vendor company?

Subject to a qualification to be noted presently, we think that this contention is without merit and that the relevant cost datum is the \$5 billion depreciated original cost. True, the \$8 billion transfer price was also an actual cost-in-fact, the only cost actually incurred by the present accounting company. But this cost does not represent a contribution of capital to the public service. Instead it represents a mere purchase by the present company of whatever legal interests in the properties were possessed by the vendor. ... [Utility] investors are not compensated for buying utility enterprises from their previous owners any more than they are compensated for the prices at which they may have bought public utility securities on the stock market. Instead, they are compensated for devoting capital to the public service. The only capital so devoted was the original \$6 billion of which \$1 billion has already been recouped from revenues earmarked as allowances for depreciation. The present company's claim is therefore merely a claim to be standing in the vendor company's shoes.”<sup>26</sup>

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<sup>26</sup> *Id.* at 238-40.

Clearly here the \$8.1 billion BNSF acquisition premium “does not represent a contribution of capital to the public service” and “[i]nstead it represents a mere purchase by [“Berkshire Hathaway”] of whatever legal interests in the properties were possessed by [BNSF].” Thus, Berkshire’s only claim is “merely a claim to be standing in the [BNSF’s] shoes,” which should not be a sufficient basis to authorize the pass-through of a substantial acquisition premium in this instance.

## **B. THE BENEFITS EXCEPTION**

The “qualification” noted by Bonbright, which sometimes applies when an acquisition premium is offset by efficiencies that benefit consumers to an equal or greater extent than the amount of the premium, is known as “the benefits exception.” In such cases compensation may be justified if the acquisition premium enabled public benefits (i.e., was devoted to public service) that would not otherwise have been obtained. Thus, in some (but not all) public utility merger or acquisition cases in which it was shown that the merger or acquisition would produce economies in the provision of public utility service that would not have been possible but for the transaction, public utility regulators have allowed the recovery through rates of a corresponding amount of any acquisition premium. As explained in one historic case:

Money is prudently invested, even though it is in excess of the original cost of the property purchased, ... if the excess was necessary for the integration of the property into a larger and more efficient system. and if the purchase necessitating the excess did or reasonably should have resulted in public benefit by

improvement of service to customers or in lowered rates or both better service and lowered rates.<sup>27</sup>

While this benefits exception can apply in certain qualifying cases of acquisition premium, it is not customarily granted lightly. As the Federal Court of Appeals for the District of Columbia has stated:

FERC has been clear that the pipeline carries the burden of proof of showing a benefits exception to justify the allowance of an acquisition premium. In order to meet this “heavy” burden, a pipeline must prove the existence of benefits to consumers that are “tangible, non-speculative, and quantifiable in monetary terms.” *Kan. Pipeline Co.*, 81 F.E.R.C. at 61,018.<sup>28</sup>

In contrast to cases such as these, where acquisition premiums were incurred to enable and achieve benefits, cost reductions and service improvements for consumers, the present acquisition of BNSF by Berkshire changes nothing except the ownership of railroad assets. The BNSF acquisition was not approved by the STB, it did not involve the merger of two railroads and it did not result in any increased operating efficiencies.

### **C. THE APPLICABILITY OF GAAP**

BNSF may claim that Generally Accepted Accounting Principles (GAAP) control here, and that the STB has no choice but to include the acquisition premium in the rate base,

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<sup>27</sup> *Re Louisiana Power and Light*, 65 PUR(NS) 23 (La. 1946).

<sup>28</sup> 601 F.3d 581 (D.C. Cir. 2010). Likewise, the STB has cited merger-created benefits for consumers as justification for allowing acquisition premiums in rate base, as in its Decision 89 concerning the CSX/Norfolk Southern/Conrail transaction: “... both CSX and NS should ultimately be financially stronger because of the synergies that the merger permits....any increase in URCS variable cost due to transaction-related changes in the value of road property investment will be offset by reductions in URCS cost elements as the \$1 billion in merger synergies flow through the costing system.” STB Finance Docket No. 33388, *Decision No. 89*, (Decided July 20, 1998) at 262-63.

because it is required under GAAP. The answer in public utility law is that, regardless of governing accounting principles, those principles cannot usurp the regulatory requirement to ensure just and reasonable rates. Utility commissions have consistently rejected arguments that accounting procedures should dictate ratemaking in yielding just and reasonable rates.<sup>29</sup> For example, in the pipeline context, FERC has addressed this subject as follows:

The Commission is not bound by accounting principles in determining whether proposed rates are just and reasonable. Merely because a cost is included as an accounting entry in an account does not mean that it is properly included in [carrier's] cost of service. "[T]hat the Commission's filing regulations contemplate possible inclusion of certain costs in rate base, does not mean automatic approval of either inclusion of the particular item or inclusion of the precise amount claimed for that item." This is so even if the accounting treatment is required by the Internal Revenue Code.

Contrary to [carrier's] allegation, it is not the duty of the Commission to justify any differences between ratemaking and accounting treatment, but rather it is [carrier's] duty to justify its attempted recovery of a cost-of-service item. [Carrier] has not shown, other than a reference to accounting procedures, why its customers should pay for monies not . . . properly accrued.<sup>30</sup>

## **CONCLUSION**

The \$8.1 billion acquisition premium paid for BNSF in this case does not represent the cost of property devoted to public service, but, rather, is a cost related exclusively to the price paid by Berkshire for BNSF stock. To grant recovery of this acquisition premium by

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<sup>29</sup> See, e.g., *Farmers Union Cent. Exch. v. FERC*, 584 F.2d 408, 418 (D.C. Cir. 1978) ("it is rates, not bookkeeping, that [the Interstate Commerce Act] requires to be reasonable, and there is no assurance . . . that reasonable accounting measures translate automatically into reasonable rates").

<sup>30</sup> *Williston Basin Interstate Pipeline Co. v. FERC*, 56 FERC ¶ 61104, 61370-71 (1991) (citations omitted), see also *Va. State Corp. Comm'n v. FERC*, 468 F.3d 845, 847 (D.C. Cir. 2006).



allowing it in the rate base for BNSF shippers whose rates are regulated would effectively result in a regulatory write-up of the valuation of BNSF assets simply because of the financial transaction that occurred and the price Berkshire agreed to pay for control of BNSF. To allow rate base inclusion of this acquisition premium would, in effect, put BNSF shippers who pay regulated rates in the position of compensating Berkshire for the mark-up above book value that Berkshire paid BNSF stockholders for their shares of BNSF stock.

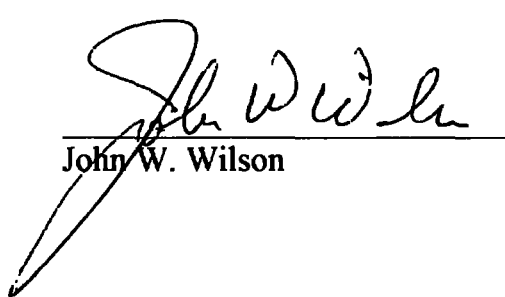
Especially in the case of those shippers paying regulated rates, the additional charges and compensation resulting from rate base inclusion of the acquisition premium would be unjust and unreasonable, as these ratepayers have already compensated investors for inflation (and will continue to do so in the future) by paying regulated rates including an ROR reflecting the current cost of capital inclusive of inflation risk. Additionally, there has been no change in basic service here warranting any suggestion by BNSF that there should be an increase in rates.

In contrast to some past utility and rail merger cases where acquisition premium amounts were allowed into rate base because the acquisition premium enabled public benefits (i.e., was devoted to public service) that would not otherwise have been obtained, there is no such justification in this case. In contrast to cases where acquisition premiums were incurred to enable and achieve benefits, cost reductions and service improvements for consumers, the recent acquisition of BNSF by Berkshire changed nothing except the ownership of railroad assets.

For these reasons it would be appropriate for the STB to exclude the \$8.1 billion acquisition adjustment from BNSF's rate base.

## VERIFICATION

I, John W. Wilson, verify that I have read the foregoing Statement, know the contents thereof, and that the same are true as stated to the best of my knowledge, information and belief. Further, I certify that I am qualified and authorized to file this statement.



John W. Wilson

Executed on October 27, 2011

## **Dr. John W. Wilson**

### **EDUCATION**

B.S.	(Senior Honors)	-	University of Wisconsin
M.S.	(Economics)	-	University of Wisconsin
Ph.D.	(Economics)	-	Cornell University

### **EMPLOYMENT**

1975 - Present	-	President, J.W. Wilson & Associates, Inc.
1973 - 1974	-	Independent Economic Consultant
1972 - 1973	-	Chief, Division of Economic Studies Federal Power Commission
1971 - 1972	-	Economist, Federal Power Commission
1969 - 1971	-	Assistant Professor of Economics (and Captain, U.S. Army); United States Military Academy; West Point, New York. Also varsity debate coach, USMA; and antitrust consultant, U.S. Department of Justice.
1966 - 1969	-	Teaching Assistant, Cornell University
1965 - 1966	-	Research Assistant, University of Wisconsin
1961 - 1965	-	Independent Insurance Agent (Licensed in the State of Wisconsin)

### **PUBLICATIONS**

"Private Passenger Automobile Insurance Profitability in Massachusetts," Massachusetts Attorney General, September, 2002.

"Actuarial Report Regarding the California Earthquake Authority's 2002 Proposed Rate Application," California Earthquake Authority, October, 2002.

"Private Passenger Automobile Insurance Profitability in Massachusetts," Massachusetts Attorney General, September, 2001.

"Merger Policy Guidelines for the Electric Power Industry." (January 1996) The Electricity Journal.

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"Competition in the Petroleum Industry," presented at the Southern Economic Association Conference, Atlanta, Georgia, 1974.

"Electricity Consumption: Supply Requirements, Demand Elasticity and Rate Design," presented at the annual meeting of the American Economic Association, December, 1973; published in the American Journal of Agricultural Economics, May, 1974.

"The Computerized Rate Case: Rate of Return", presented at the Regulatory Information Systems Conference, Missouri Public Service Commission, October, 1973; published in Proceedings.

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The Port of Milwaukee: An Economic Review, University of Wisconsin Press, 1967 (collaborator).

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### **EXPERT TESTIMONY:**

Before the U.S. House of Representatives -

Committee on Interstate and Foreign Commerce, Subcommittee on Energy and Power; expert testimony concerning the effects of regulation in the natural gas industry, May 1977.

Committee on the Budget, Task Force on Distributive Impacts of Budget and Economic Policies; expert testimony on natural gas matters, 1977.

Committee on the Judiciary, Subcommittee on Monopolies & Commercial Law; expert economic testimony dealing with anticompetitive problems in the U.S. petroleum industry, February 25, 1976.

Committee on Interstate and Foreign Commerce, Subcommittee on Energy and Power; expert testimony pertaining to the deregulation of the field price of natural gas, January 30, 1976.

Committee on Interstate and Foreign Commerce, Subcommittee on Energy and Power; expert testimony concerning natural gas producer regulation, March 1975.

Committee on Interstate and Foreign Commerce, Subcommittee on Telecommunications, Finance and Consumer Protection; expert testimony pertaining to current structure of the telecommunications industry, June 1980.

Committee on the Judiciary, Subcommittee on Monopolies and Commercial Law Oversight Hearings on Mergers and Acquisitions; expert testimony concerning merger policy and antitrust enforcement, December 1981.

Committee on Energy and Commerce, Subcommittee on Energy Generation and Power; expert testimony concerning competition in the electric power industry and the importance of public preference on hydroelectric relicensing in that regard, 1986.

Committee on the Judiciary, Subcommittee on Monopolies and Commercial Law, September 13, 1984; expert testimony concerning competition in the insurance industry.

Before the United States Senate -

Joint Economic Committee, Subcommittee on Energy; expert testimony concerning antitrust problems related to the development of an integrated fuels industry in the United States; November 1975.

Committee on the Judiciary, Subcommittee on Antitrust and Monopoly; expert testimony dealing with integration between the oil, coal, and nuclear industry, June 1975.

Committee on the Judiciary, Joint Hearing before the Subcommittee on Antitrust and Monopoly and the Subcommittee on Administrative Practice and Procedure; expert testimony dealing with natural gas reserves in the United States, October 1973.

Committee on Commerce; expert testimony on market conditions in the natural gas producing industry and field price regulation, October 1973.

Committee on the Judiciary, Subcommittee on Antitrust and Monopoly, expert testimony dealing with competition in the petroleum industry, June 1973.

Committee on the Judiciary, Subcommittee on Antitrust and Monopoly; expert testimony on matters pertaining to S.403, A Bill to Prohibit Certain Combinations and Control Between Electric and Gas Utilities, May 1971.

Committee on Government Operations; expert testimony pertaining to S.607, A Bill to Establish an Office of Utility Consumers' Counsel, 1970.

Committee on the Judiciary; expert testimony concerning the proposed settlement of the AT&T antitrust lawsuit, March 1982.

Committee on Energy and Natural Resources, Subcommittee on Water and Power; expert testimony concerning competition in electric power industry and the importance of public preference in hydroelectric relicensing, 1986.



**Before the American Arbitration Association -**

Commercial Arbitration, Dallas Division, No. 71 198 00323 01, Report regarding control, ownership and operation of Cleburne generating plant, competition between Brazos and Enron and Enron's status as an electric utility on behalf of Claimant, Brazos Electric Power Cooperative, Inc., March 12, 2003.

**Before the California State Legislature -**

Expert testimony on matters dealing with natural gas supply in the State of California.

Assembly Committee on Natural Resources and Energy of the California Assembly. A Report to the California State Assembly, March 1983.

Expert testimony on matters pertaining to profitability, competition and discrimination in California property/ casualty insurance markets before the California State Assembly, 1986.

**Before the New York State Legislature -**

Expert testimony on matters dealing with natural gas supply in the State of New York.

Expert testimony concerning medical malpractice insurance rates and profits in New York. February, 1988.

**Before the Texas State Legislature -**

Expert testimony before the Texas State Legislature concerning insurance rate regulation and industry data reporting to the State Insurance Board, 1989.

**Before the Virginia State Legislature -**

Expert testimony before the Virginia House of Delegates on behalf of the Attorney General concerning the need for improved regulation of rates charged by property/casualty insurance companies in the State of Virginia (various dates 1987-1989).

Expert testimony before the Virginia Senate on behalf of the Attorney General in support of legislation strengthening the regulation of property/casualty insurance companies rates for commercial liability insurance by the Virginia Corporate Commission (various dates 1987-1989).

**Before the Federal Communications Commission -**

Affidavit dealing with the economic structure and performance of competitive markets in connection with implementation of wide area paging systems.

Expert witness concerning AT&T's migration strategy.

Expert witness in CC Docket No. 80-286; testimony on cost methods.

Before the Federal Energy Regulatory Commission (formerly Federal Power Commission) -

Expert witness in Docket ER76-205, Southern California Edison Company; testimony concerning rate of return and other related financial issues.

Expert witness in Docket ER77-175, Florida Power & Light Company; testimony concerning transmission service rate and related antitrust issues.

Expert witness in Docket ER76-304, New England Power Company; testimony concerning rate of return.

Expert witness in Docket No. ER76-495, Carolina Power & Light Company; testimony concerning rate of return and related financial issues.

Expert witness in Docket No. ER76-45, Consumers Power Company; testimony concerning antitrust and bulk power supply issues.

Expert witness in Docket No. RP76-57-1, Plant City Natural Gas Case; testimony concerning special exemptions for natural gas curtailments.

Expert witness in Docket No. CP74-192, Florida Gas Transmission Company; testimony concerning natural gas supply, and pipeline abandonment and conversion to oil products line.

Expert witness in Docket No. E-9147, Virginia Electric & Power Company; testimony concerning rate of return.

Expert witness in Docket No. E-8884, Carolina Power & Light Company; testimony concerning rate of return, managerial efficiency, and cost of service.

Expert witness in Docket No. E-8570, Southern California Edison Company; testimony concerning rate of return, economic efficiency, cost of service, fuel adjustment clause, and anticompetitive price discrimination.

Expert witness in Docket No. E-8176, Southern California Edison Company; testimony concerning rate of return.

Expert witness in Docket No. RP74-50-5, Florida Hydrocarbons Company and Florida Gas Transmission Company; testimony concerning natural gas curtailment exemptions for liquefied petroleum gas production.

Expert witness in Docket No. E-8881, Carolina Power & Light Company; testimony concerning rate of return and related economic matters.

Expert Economic Policy Witness in Docket No. CI73-501, Louisiana Land and Exploration Company; testimony concerning prices and competition.

Expert Rate of Return Witness in Docket No. E-7738, Boston Edison Company.

Expert Economic Policy Witness in Docket No. CI73-293, et al., Belco Petroleum Corporation, et al.; testimony concerning prices and competition.

Expert Economic Policy Witness in Docket No. E-7679, Florida Power Corporation; testimony concerning rate of return, rate structure design and antitrust matters.

Expert Economic Policy Witness in Docket No. CI72-301, et al., Northern Michigan Exploration Company, et al.; testimony concerning prices and competition.

Expert Witness on matters pertaining to competition in Docket No. E-7618, Southern California Edison Company.

Expert Rate of Return Witness in Docket No. E-7645, Public Service Company of Indiana.

Expert Rate of Return Witness in Docket No. E-7602, Central Telephone & Utility Corporation.

Expert witness for City of Anaheim, California in Docket No. ER76-205, Southern California Edison Company; testimony dealing with rate of return issues.

Expert witness in Docket Nos. ER78-19, ER78-81, Florida Power & Light Company; testimony concerning prices and competition.

Expert witness in Docket No. ER76-714, Indiana & Michigan Electric Company; testimony concerning rate of return.

Expert witness for the Municipal Wholesale Power Group in Docket No. ER77-347, Wisconsin Power & Light Company; testimony concerning price squeeze issues.

Expert witness in Docket Nos. EL78-15 and ER78-339, Public Service of New Hampshire; concerning the inclusion of construction work in progress in rate base.

Expert witness in Docket No. ER78-379, et al., Indiana & Michigan Electric Company; testimony concerning rate of return and capital structure.

Expert witness in Docket No. OR78-1, Trans-Alaska Pipeline; testimony concerning rate of return, rate base, and capital structure.

Expert witness in Docket No. OR79-1, Williams Pipe Line Company; testimony concerning rate base valuation and related regulatory issues.

Expert witness in Docket No. ER78-522, Virginia Electric & Power Company; testimony concerning price squeeze issues.

Expert witness in Docket ER78-360, Connecticut Yankee Atomic Power Company; testimony concerning rate of return and related issues.

Expert witness in Docket No. RP83-11, Transcontinental Gas Pipeline Company; testimony concerning rate of return and sales volumes.

Expert witness in Docket No. ER82-427-000, Southern California Edison Company; testimony concerning fuel procurement practices and nuclear plant operating efficiency.

Expert witness in Docket No. ER82-483-000, Middle South Utilities Company; testimony concerning equalization of costs.

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Expert witness in Docket No. ER83-609, Southwestern Electric Power Company; testimony concerning cost of capital and rate of return.

Expert witness in Docket No. ER85-204-000, South Carolina Generating Company, Inc.; testimony concerning corporate reorganization and the application for initial rate schedule.

Expert witness in Docket Nos. ER85-646-005 and ER85-647-003 (Phase II), New England Power Company; testimony concerning the issue of the proper regulatory treatment of abandoned plant costs.

Expert witness in Docket No. ER84-571 (Phase I), Utah Power and Light; on behalf of the Western Area Power Administration (WAPA) and other parties concerning Utah Power and Light's application to overturn fixed price contracts.

Expert witness in Docket Nos. ER86-76 and ER86-230, Commonwealth Edison Company; testimony concerning Commonwealth Edison's proposed "marginal cost-based" tariffs for wheeling services.

Expert witness in Docket No. ER85-785-001, Wisconsin Electric Power Company; testimony concerning proposed "value of service" rates for transmission services.

Expert witness in Docket No. RP86-119-000, Tennessee Gas Pipeline Company; testimony concerning the proper regulatory treatment of gas supply contract reformation costs and excess take or pay costs.

Expert witness in Docket No. RP86-126-000; Transwestern Pipeline Company; testimony concerning the proper regulatory treatment of gas supply contract reformation costs and excess take or pay costs.

Expert witness in Docket No. RM85-17 on behalf of the American Public Power Association concerning proposed rules and regulations pertaining to the implementation of new economic pricing techniques for wholesale electric utility services and ratemaking, and the competitive implications of risk sharing between buyers and sellers of wholesale services.

Expert witness in Docket No. ER-84-31-000, Central and South West Services, Inc.; testimony concerning competition in the electric utility industry and the potential competitive impact of the proposed Central and Southwest pool.

Expert witness in Docket No. RP87-103-000, Panhandle Eastern Pipeline Company; testimony concerning regulatory and economic principles that are violated by proposal of Indiana Gas company regarding recovery of gas supply costs.

Expert witness in Docket No. 88-68, Transcontinental Gas Pipeline Corporation; testimony concerning proposal of "Indicated Shippers" regarding recovery of gas supply costs and violation of regulatory and economic principles.

Expert witness in Docket Nos. ER89-256-000, ER90-333- 000, EC89-10-000, Palisades Generating Company; testimony concerning certain aspects of proposed "Purchase Power Agreement" and other related agreements.

Expert witness in Docket Nos. EC90-10-000, ER90-143-000, ER90-144-000, ER90-145-000, and EL90-9-000, Northeast Utilities Service Company (re Public Service Company of New Hampshire); testimony concerning economic aspects of a proposed utility acquisition as well as related regulatory policies and competitive issues.

Expert witness in Docket Nos. ER90-374-000, ER90-373-000, ER90-390-000, ER90-373-001, ER90-090-00, Northeast Utilities Service Company; testimony on concerns expressed by the Commission in its Orders of August 28, 1990 and October 31, 1990 regarding the "opportunity cost" provisions in Northeast Utilities transmission agreements and to respond to its expressed views in this regard.

Expert witness in Docket Nos. EC90-10-007 and ER93-294-000; affidavit concerning arguments expressed by Northeast Utilities Service Company with respect to "opportunity cost" rates.

Expert witness in Docket No. ER92-331-000 and ER92-332-000; testimony concerning economic issues related to "open access" transmission service Consumers Power Company claims to offer in its proposed tariff and the non-firm transmission service offered in its proposed coordinated operating agreement between CPCo, the Michigan Public Power Agency, and Wolverine.

Expert witness in Docket Nos. ER92-595-000, ER92-596-000 and ER92-626-000; Pacific Gas & Electric Company, Southern California Edison, et al., testimony concerning anticompetitive effects of the unreasonable restrictions and limitations that would be imposed on TANC and its Members by the rate and service schedules filed by the Companies.

Expert witness in Docket No. ER93-465-000, Florida Power & Light; affidavit concerning the discriminatory and anticompetitive practices of FPL and imposed costs on Florida cities.

Expert witness in Docket No. RP92-166-000. Panhandle Eastern Pipe Line Company; rebuttal testimony concerning FERC staff witness' recommended common equity return allowance.

Expert witness in Docket No. RP93-109-000, Williams Natural Gas Company; testimony concerning the appropriate rate of return allowance in addition, to determine whether WNG's proposed rates are discriminatory, preferential or anticompetitive.

Expert witness in Docket Nos. TX93-4-000 and EL93-51-000; Florida Power & Light Company; affidavit dealing with the amount of network transmission service that FPL would require Florida Municipal Power Agency to buy in order to receive service and FPL's proposed restrictions on FMPA's access to transmission interconnections with other utilities.

Expert witness in Docket Nos. ER93-465-000, et al., Florida Power & Light Company; testimony regarding competitive issues concerning "open access" transmission service and appropriate rate of return for wholesale rates.

Provide advice and comments on behalf of Pennsylvania Boroughs in Docket Nos. RM95-8-000 & RM95-7-000 regarding NOPRs proposed treatment of stranded costs.

Expert witness in Docket No. ER95-112-000; Entergy Services, Inc.; testimony regarding the Comparability of Entergy open-access tariffs.

Expert witness in Docket No. EC96-10-000, Baltimore Gas and Electric Company, Potomac Electric Power Company; testimony filed on behalf of the DC Office of People's Counsel on competition and merger related market power issues.

Expert witness in Docket No. EC96-13-000, et al., The Wisconsin Intervenors; examination of economic issues relating to proposed merger with a focus on market power issues.

Expert witness in Docket No. EC96-13-000, et al., Badger Cooperative Group, et al.; testimony on Remedies.

Expert witness in Docket No. EC97-5-000, Ohio Edison Company, Pennsylvania Power Company, The Cleveland Electric Illuminating Company, Toledo Edison Company; affidavit submitted on behalf of the Boroughs of Ellwood City, Grove City and Zelienopole, Pennsylvania concerning Applicant's "Order Compliance Filing" in response to the Commission's July 16, 1997 Order regarding the competitive impact of the merger.

Expert witness in Docket Nos. EC97-5-000, Ohio Edison, Pennsylvania Power Company, The Cleveland Electric Illuminating Company, The Toledo Edison Company; affidavit submitted on behalf of Industrial Energy Users-Ohio, regarding economic issues pertaining to Applicant's Compliance Filing in response to Commission's July 16, 1997 Order.

Expert witness in Docket No. EC97-5-000, Ohio Edison Company, Pennsylvania Power Company, The Cleveland Electric Illuminating Company, The Toledo Edison Company; affidavit filed on behalf of the City of Cleveland regarding its protest and the impact of merger on competition in electric power markets.

Expert witness in Docket No. EC97-56-000, Western Resources and Kansas City Power & Light Company; affidavit filed on behalf of The Kansas City Board of Public Utilities regarding merger related market power issues.

Expert witness in Docket Nos. EC98-1-000 & ER98-6-0000, New England Power Company, The Narragansett Electric Company, U.S. Gen New England, Inc., Application for Required Approvals Under Sections 203 & 205 of the Federal Power Act for Divestiture of Generating Business & Related Matters; affidavit filed on behalf of the Town of Norwood, Massachusetts concerning economic issues resulting from NEP's sale of all its non-nuclear generation assets to U.S. Generating.

Expert witness in Docket No. EC98-40-000, American Electric Power Company, Inc., Central & South West Corporation; affidavit filed on behalf of American Electric Group Intervenors concerning merger related market power issues as a result of the merger between AEP & CSW.

Expert witness in Docket No. RP95-364-005, Williston Basin Interstate Pipeline Company; testimony filed on behalf of the Public Utilities Commission of South Dakota and the Montana Consumer Counsel concerning investors' long term growth expectation component of the discounted cash flow (DCF) model, November, 1999.

Expert witness in Docket Nos. ER99-28-001, ER99-28-003, EL99-38-002 and ER99-945-002, Sierra Pacific Power Company; testimony filed on behalf of the Transmission Agency of Northern California concerning the interconnection of the Alturas Intertie Project with the Pacific Northwest-Southwest AC Intertie, January, 2000.

Expert witness in Docket Nos. EC00-55-000 & ER00-1520-001, CP&L Holdings, Inc. and Florida Progress Corporation, affidavit filed on behalf of The Florida Cities concerning market power issues as a result of the proposed merger of CP&L and FPC, April 2000.

Expert witness in Docket No. EC00-63-000, Sierra Pacific Power, Nevada Power Company and Portland General Electric Company, affidavit filed on behalf of The Transmission Agency of Northern California concerning merger related market power issues and the potential for anticompetitive exploitation by applicants, May 2000.

Expert witness in Docket No. EC01-33-000, FPL Group and Entergy Corporation, affidavit filed on behalf of Seminole Electric Cooperative and Florida Municipal Power Agency concerning competitive market and ratepayer protection issues as a result of proposed merger between FPL and Entergy, January 2001.

Expert witness in Docket No. EL01-80-000, National Grid USA, affidavit concerning competitive market issues as a result of National Grid's Petition for a Declaratory Order, declaring they not be deemed a "market participant" as defined by Commission regulations with respect to region served by the Alliance RTO, June 2001.

Expert witness in Docket No. ER01-1639-000, Pacific Gas & Electric Company, testimony filed on behalf of the Northern California Power Agency concerning economic arguments of PG&E proposed amendment to Contract 2948A with Western Area Power Administration, September 2001.

Expert witness in Docket Nos. EC01-156-000 and ER01-3254-000, Alliant Energy Corporate Services, Inc., MidAmerican Energy Company, Xcel Energy Services, Inc., TRANSLink Transmission Company, affidavit filed on behalf of IAMU, CMMPA, and MMUA concerning economic, cost of capital and competitive market issues, November 2001.



Expert advice and analysis in Docket No. RM01-12-000, Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design; comments filed on behalf of Montana Consumer Counsel concerning FERC SMD Proposal, November, 2002.

Expert witness in Docket No. EL03-37-000, Town of Norwood, Massachusetts v. New England Power Company; testimony filed on behalf of Town of Norwood concerning complaint against National Grid, USA for imposing unlawful and excessive rates and charges, December, 2002.

Expert witness in Docket Nos. EL00-95-000, et al., San Diego Gas & Electric Company, et al.; testimony on behalf of interveners City of Burbank, City of Glendale, Imperial Irrigation District and Turlock Irrigation District concerning alleged market manipulation. February, 2003.

Expert advice and analysis in Docket Nos. EL01-118-000 and EL01-118-001 on behalf of Montana Consumer Counsel, comments on proposed revisions to market-based rate tariffs and authorizations, July 2003.

Expert witness in Docket Nos. ER00-2019-006, et al., California Independent System Operator Corp.; testimony filed on behalf of the California Department of Water Resources State Water Project concerning transmission cost allocations, economic efficiency and rate structure design, September 2, 2003.

Expert witness in Docket Nos. EL03-180-000, et al., Enron Power Marketing Inc., et al.; testimony filed on behalf of City of Glendale responding to allegations reflected in Commission's *Order to Show Cause Concerning Gaming and/or Anomalous Market Behavior Through the Use of Partnerships, Alliances or Other Arrangements and Directing Submission of Information*, September, 2003.

Expert witness in Docket No. ER03-1223-000, Montana Megawatts I, LLC, affidavit filed on behalf of the Montana Consumer Counsel concerning NWE/MMI proposed power sales rate formula in support of their request that the Commission accept their "cost based" Power Purchase Agreement as an initial rate filing, October 2003.

Expert witness in Docket Nos. ER04-157-000, Bangor Hydro, et al.; testimony filed on behalf of the New England Consumer Owned Entities (NECOE), concerning Joint Return on Equity filing by the New England Transmission owners made in connection with the proposed formation of a Regional Transmission Organization for New England, December 2003.

Expert advice and analysis in Docket Nos. ER 93-465-033, ER 93-417-002, ER 96-1375-003, OA 96-39-010 and OA 97-245-003, Florida Power & Light Company; Affidavit regarding anticompetitive transmission cost discrimination, June 2004.

Expert witness in Docket Nos. ER-03-563-030, Devon Power, LLC, et al testimony on the design of a locational installed capacity ("LICAP") market in New England.

Expert witness on behalf of Wellesley Municipal Light Plant, Reading Municipal Light Department, and Concord Municipal Light Plant in Docket Nos. ER-03-563-030 Devon Power, LLC et al.; testimony regarding LICA pricing and demand curve parameters. November 2004.

Expert Witness in the matter of PPL Montana, LLC, Docket No. ER 99-3491-003, ER-00-2184-001 and ER00-2185-001. Affidavit dealing with PPL Montana's Market Power Analysis. January 2005.

Affidavit in the matter of PPL Montana, LLC, Dockets No. ER 99-3491-003, ER-00-2184-001, ER00-2185-001, EL05-124-000 and Delivery Price Test dealing with PPL Montana's Market Power Analysis. November 2005.

Expert witness in the matter of Market-Based Rates for wholesale Sales of Electric Energy Capacity and Ancillary Services by Public Utilities. Docket No. RM04-7-000. August 2006.

Expert Witness in the matter of Mystic Development, LLC, on Behalf of Wellesley Municipal Light Plant, Reading Municipal Light Plant, Concord Municipal Light Plant, And Massachusetts Municipal Wholesale Electric Company Docket No. 06-427-000. November 9, 2006.

Expert witness in Docket No. EL03-37-000, Town of Norwood, Massachusetts v. National Grid USA, New England Electric System, New England Power Company, Massachusetts Electric Co. and Narragansett Electric Company; Affidavit filed on behalf of Town of Norwood. May 2007.

Expert Witness in Docket ER08-552-000, Niagara Mohawk Power Corporation Affidavit on behalf of the New York Association of Public Power ("NYAPP) and several of its members (Green Island Power Authority, the Jamestown Board of Public Utilities, the City of Salamanca, the City of Sherrill, the Village of Solvay and Oneida Madison). March 17, 2008.

Expert witness in the matter of ISO New England, Inc. March 17, 2008.

Expert advice in the matter of New York Regional Interconnect, Inc. Docket No. ER08-39-000. June 2008.

Before the International Trade Commission -

Expert witness on the profitability of AT&T's Small Business Telephone Systems and Subassemblies, Inv. Nos. 731-TA-426-428(F).

Before the Nuclear Regulatory Commission -

Affidavit dealing with proposed licensing conditions pertaining to a new nuclear power plant to be constructed by the Florida Power & Light Company, April 1976.

Affidavit dealing with proposed licensing conditions pertaining to a proposed Nuclear Power Plant License Renewal, Docket No. 90-16500, October 1990.

Before the Securities & Exchange Commission -

Expert economic witness for the U.S. Justice Department on the matter of American Electric Power Company, Inc., SEC File No. 70-4596 (proposed merger with Columbus & Southern Ohio Electric Company), February-March, 1971.

Before the United States Department of Energy -

Dealing with gas supplies and natural gas pipeline service to Florida.

Before the Federal Maritime Commission -

Expert witness in Docket No. 85-3. Matson Navigation Company, Inc.; testimony concerning proposed overall rate increase.

Before the U.S. Court of Federal Claims -

Expert witness in Brazos Electric Power Cooperative, Inc. v. The United States, No. 98-837C, affidavit filed on behalf of Brazos concerning economic damages suffered as a result of the Government's breach of contract, October 2001.

Before the U.S. District Court for the -

Northern District of New York, Expert witness in 79-CV-163, Town of Massena, New York v. Niagara-Mohawk Power Corporation; testimony concerning antitrust issues pertaining to Massena, New York's establishment of a municipal electric distribution system.

District of Connecticut, expert witness in antitrust liability and damage phases of Jury Trial in Civil Action B-75-319, Northeastern Telephone Company v. American Telephone & Telegraph Company, et al.

District Court of Maryland, expert witness in Civil Action No. K83-2990, City of Hagerstown, Town of Thurmont and Town of Williamsport, Maryland v. The

Potomac Edison Company, Allegheny Service Corporation; testimony concerning the price elasticity of demand for electric power.

District Court of Wyoming, expert witness in Civil Action No. C82-0443; testimony concerning the motivations and consequences of Burlington Northern Railroad's alleged monopolization of coal supplies from the Powder River Basin in Wyoming.

District Court of Wyoming, expert witness in Civil Action No. C-86-0172, January, 1988, concerning natural gas markets in the Rocky Mountain area.

District Court of Massachusetts, expert witness in Civil Action No. 87-1881-C concerning antitrust liability issues and economic damages sustained by the Towns of Concord and Wellesley, Massachusetts, 1989.

Eastern District of Missouri, Southeastern Division, expert witness in Civil Action No. S83-288c concerning economic damages sustained by the Town of Malden, Missouri, resulting from alleged antitrust violation by Union Electric Company.

District of New Mexico, expert witness in Civil Action No. CV84-1430-JB concerning the carbon dioxide market in the Bravo Dome area of Northeastern New Mexico.

District of Alabama, expert witness in Civil Action concerning the constitutionality of "tort reform" legislation limiting punitive damages. Testimony concerned the profitability of the property/casualty insurance industry in the State of Alabama, 1989.

Eastern District of Missouri, Civil Action No. 83-2756(c), expert testimony quantifying the damages resulting from alleged anticompetitive practices by the Union Electric Company.

Southern District of Texas, Houston Division, Civil Action No. H-91-627, expert witness regarding anticompetitive practices and quantifying the damages resulting from the alleged anticompetitive practices by Baker Hughes Inc., Hughes Tool Company, Reed Tool Company, Camco International Inc., and Smith International, Inc.

Middle District Court of Alabama, Northern Division; Civil Action No. 89-H-519N; expert witness evaluating private agreements between the defendants meet the purpose of the "active supervision" test for state action immunity.

U.S. District Court for the District of Kansas, Case No. 85-2349, expert witness concerning competitive markets in the natural gas industry and the quantification of damages resulting from the alleged anticompetitive conspiracy of Amoco and affiliates with Cities Service Gas Company, its parent corporation, and affiliates.

Northern District of Alabama, Southern Division, Civil Action No. CV-91-PT-00445-S, affidavit concerning the impact on competition in the relevant market caused by various actions of Southern Natural Gas Company and Alabama Gas Corporation.

District of Minnesota, Third Division, Civil Action No. CV-3-90-240; affidavit concerning anticompetitive practices and resulting damages caused by of Fujitsu Systems of America, Inc.

Northern District of Illinois, Eastern Division, Civil Action No. 87 C 3839; report on Ecolochem's lost profits due to Arrowhead's alleged patent infringement.

Middle District of Florida, Orlando Division, Case No. 92-35-CIV-Orl-18; affidavit concerning Florida Power & Light Company's position and conduct for purposes of determining their competitive implications in light of Section 2 of the Sherman Act.

Western District of Oklahoma, Civil Action Nos. 89 1186 T and 89 822 T; affidavit concerning workers compensation rates in Oklahoma and anticompetitive conspiracy between the defendants and anticompetitive pricing.

District of New Mexico, No. CIV 93-0397 SC/WWD, report concerning damages sustained by New Mexico insurance agencies as a result of adverse actions taken by CIGNA in connection with COMPAR program in which agencies were participants.

District of Minnesota, Fourth Division, expert witness in Civil File No. 4-93 Civil 577, affidavit concerning the effect of reinsurance costs in setting premiums and the reasonable rate of return in workers compensation insurance.

District of Colorado, report prepared to evaluate economic damages in Civil Action No. 94-K-728, June, 1996.

District of New Mexico, report prepared to review and analyze pricing and royalty payments in order to assess economic damages in Civil Action, No. 95-12 JC/WWD, February, 1997.

District of Ohio, expert witness in Civil No. CV96-0308-E-BLW, Snake River Valley Electric Association v. PacifiCorp; affidavit filed on behalf of SRVEA regarding the competitive structure of electric utility markets in which PacifiCorp and SRVEA operate, September, 1997.

District of Massachusetts, Expert witness in Case No. 97-CV10818-PBS, Town of Norwood Massachusetts v. New England Power Company; affidavit filed on behalf of the Town of Norwood, September, 1997.

Southern District of Iowa, Central Division, expert witness in Case No. 4-97-CV-80782, North Star Steel Company v. Mid American Energy Holdings Company and Mid American Energy Company; declaration filed on behalf of NSSC regarding economic issues relating to regulation, antitrust and competition in the electric utility industry, February, 1998.

Eastern District of Michigan, expert witness in Docket No. 97-10366, Indeck Energy Services v. Consumers Energy Company; affidavit filed on behalf of Indeck concerning competition February, 1998.

Eastern District of Texas, expert witness in Civil Action No. H-97-3994, North Star Steel Texas Inc. V Entergy Gulf States, Inc.; declaration filed on behalf of North Star regarding market structure and competition, March, 1998.

Middle Pennsylvania, expert witness in Civil Action No. 4:CV-96-2176, AVCO v. Superior Air Parts, Inc.; report filed on behalf of AVCO concerning economic damages suffered as a result of alleged actions by defendants.

District of Colorado, expert witness in Case No. 96-Z-2451, United States Government and CO<sub>2</sub> Claims Coalition, LLC v. Shell Oil Company, Shell Western E&P, Inc., Mobil Producing Texas and New Mexico, Inc. and Cortez Pipeline Company; report submitted on behalf of Plaintiffs' concerning Defendants' pricing and royalty payment practices for carbon dioxide gas produced from the McElmo Dome CO<sub>2</sub> gas unit in Colorado, August, 1998.

District of Nebraska, expert advice and analysis in Civil Action No. 8:97CV-346. Report filed on behalf of Nebraska Public Power District concerning NPPD's Nuclear Decommissioning Trust Fund Investments, April 1999.

Middle District of Pennsylvania, expert witness in Case No. 3:CV-01-2308, Borough of Olyphant, Pennsylvania v. PP&L, Inc., PP&L Corporation, and PP&L Generation, L.L.C.; affidavit concerning competitive structure of electric utility markets in which PP&L and Olyphant operate, PP&L market power and anticompetitive injury suffered by Olyphant as consequence of PP&L conduct, December, 2002.

District of Montana, Billings Division, Expert witness in CV-03-129-BLG-RWA, Upper Missouri Generation & Transmission Electric Cooperative, Inc. v. Western Plains Electric Cooperative, Inc.; Damages Report, March 2004.

Southern District of Texas, affidavit in the matter of Gary R. Shannahan, Daniel L. Mortland, And Kathryn M. Scott Individually And For Others Similarly Situated Dynegy, Inc., Dynegy Inc. Benefit Plans Committee, Louis Dorey, Robert D. Doty, Jr., Alec G. Dreyer, Andrea Lang, Michael Mott, Milton L. Scott, And R. Blake Young. Civil Action No. 4:06-cv-00160 (September 15, 2006).

District of Columbia, Expert Witness in Case No. 1:04cv-00940-RWR, City of Moundridge , et al v. Exxon-Mobil Corporation et al. May 2008.

Before the Circuit Court of the Second Judicial Circuit, State of Florida -

Expert witness in Florida Excess Profits Statute Enforcement; testimony concerning excess profit levels in the private passenger automobile insurance industry in the state of Florida.

Expert testimony on behalf of the State of Florida Insurance Department concerning the constitutionality of and technical need for the recent strengthening of the State's insurance regulatory law as it is applied to commercial liability insurance rates. (1986)

Before the Missouri Circuit Court of Callaway County -

Expert witness in Case No. CV 587-4; testimony concerning rates to be charged for electric transmission services; 1989.

Before the Superior Court of New Jersey, Law Division, Cumberland County -

Expert witness in Docket No CUM-L-001206-00, Atlantic City Electric Company; on behalf of The City of Vineland, New Jersey. Report on The Fair Market Value of Property to be Acquired by The City of Vineland, New Jersey from the Atlantic City Electric Company, July 2000.

Before the Superior Court Division of North Carolina, Wake County -

Affidavit concerning North Carolina workers compensation insurance regulatory framework and the effect of residual market service carrier fees on employers costs of workers compensation insurance and the extent to which the fees are subject to regulatory scrutiny and control.

Before the St. Lawrence County (New York) Court Commissioners of Appraisal -

Expert testimony, Index 59244 concerning the condemnation value to be established for Niagara Mohawk's distribution property being acquired by the Town of Massena, New York to establish a municipal system.

Prepared for the St. Lawrence County (New York) -

Preliminary report for the Towns and Villages of Canton and Potsdam, New York; feasibility and legal considerations for the establishment of a municipal electric system, August 1996.

Before the Maine Superior Court of Kennebec County -

Expert witness in Docket No. CV-85-459, NCCI v. Superintendent of Insurance, witness for the State of Maine concerning the reasonableness of Maine's workers compensation insurance regulatory law.

Before the Arizona Superior Court, Coconino County -

Expert testimony in Case No. 39780 on behalf of the City of Page, Arizona, concerning the condemnation value of electric utility properties being taken by the City of Page to establish its own municipally-owned electric utility system.

Before the Arizona Superior Court, Maricopa County -

Expert witness in Civil Action No. 87-36278 concerning the condemnation value of electric utility properties being taken by the City of Gilbert to establish its own municipally owned electric utility system, 1989.

Before the California Superior Court for San Francisco -

Expert testimony in Case No. 843144 concerning the anticompetitive nature of anti-rebate laws applicable to the California property/casualty insurance industry.

Before the California Superior Court, Sacramento County -

Expert advice and analysis in Case No. 98AS052270 on behalf of California consumers of diesel fuel concerning anticompetitive pricing among certain oil companies doing business in the State of California, July, 1999.

In the Court of Common Pleas, State of South Carolina, County of Greenville

Affidavit providing a description of the overall framework of the South Carolina workers compensation insurance regulatory scheme with a focus on residual market servicing carrier fees; Case No. 93-CP-23-2428, October 1996.

Report filed in Case No. 94-CP-23-2428 on economic liability and anticompetitive damages for workers' compensation insurance buyers in South Carolina, May, 1998.

In the Circuit Court for Bullock County, Alabama

Affidavit quantifying the direct economic value of proposed settlement to workers compensation purchaser in Alabama; Civil Action No. CV-94-82.80, October 1996.

In the Circuit Court of the 11<sup>th</sup> Judicial Circuit in and for Miami-Dade County, Florida



Expert witness in Case No. 99-17626 CA 23, Violeta Sobrado Rothe, et al. v. Amedex Insurance Company; testimony concerning the usage and importance of the terms “class” and “block” in the insurance industry, June 2001.

In the Circuit Court of the 15<sup>th</sup> Judicial Circuit in and for Beach County, Florida

Expert witness in Case No. CL94-3275 AD, National Council on Compensation Insurance, Inc. et al., vs. Uniforce Temporary Personnel, Inc. et al. Retained by Uniforce to testify as to damages suffered as a result of NCCI’s alleged improper determination of its Experience Modifier between 1988 and 1992, May, 1997.

In the District Court of Travis County, Texas, 53<sup>rd</sup> District & 250<sup>th</sup> Judicial District Court

Expert witness in Consolidated Action Nos. 97-08264 and 95-15470; report filed on behalf of Plaintiffs, on class certification issues regarding economic conspiracy and damages, January, 1998.

In the District Court of Harris County, Texas, 269<sup>th</sup> Judicial District Court

Expert advice and analysis in Cause No. 96-016613, Cities of Wharton, Pasadena and Galveston v. Houston Lighting & Power Company. Expert Report filed on behalf of Cities concerning municipal franchise fees, October, 1999.

In the Circuit Court of Coahoma County, Mississippi

Expert witness in Civil Action No. 14CI-97-0006, Mississippi Valley Gas Company vs. City of Clarksdale Public Utilities Commission; testimony on behalf of City of Clarksdale concerning allegations and evidence relating to antitrust liability and damages, August 1998.

In the District Court of Johnson County, Texas, 249<sup>th</sup> Judicial District Court

Affidavit in Cause No. C-2002-00267; Brazos Electric Power Cooperative, Inc. v. Ponderosa Pine Energy, L.L.C., et al., on behalf of Brazos Electric Power Cooperative, Inc. regarding control, ownership and operation of Cleburne generating plant, competition between Brazos and Enron, and Enron’s Status as an electric utility, August 4, 2003.

Before the Alabama Public Service Commission -

Expert witness in Docket No. 17667, Alabama Power Company; testimony concerning rate base and cost of service issues.

Expert witness in Case No. 18548, South Central Bell Telephone Company; testimony concerning the restructuring of WATS rates.

Expert witness in Docket No. 1882, South Central Bell Telephone Company; testimony dealing with the Company's proposed levels of revenue, expenses, rate of return and rate base.

Before the Governor of Alabama's Special Commission on Insurance Regulation and Tort

Expert testimony on profitability in the property/casualty insurance industry and the underlying causes of the liability insurance crisis, 1986.

Before the Alaska Pipeline Commission -

Expert witness in Docket P-78-5, Northpole Refinery; testimony on cost allocation and rate design issues.

Before the Arizona Corporation Commission -

Expert witness for Honeywell Information Systems, Inc. in Docket No. U-1345, Arizona Public Service Company; testimony concerning cost of service and marginal cost pricing.

Expert witness in Docket No. 9981-E-1051-83, Mountain States Telephone and Telegraph Company; testimony concerning financial condition, cost of capital and rate of return.

Expert witness in Docket No. U-1345-83-155, Arizona Public Service Company; testimony concerning financial condition, earnings level, cash flow and incentive regulation.

Expert witness in Docket No. 9981-E-1051-83-286, Mountain States Telephone and Telegraph Company; testimony dealing with post-divestiture cost estimates.

Expert witness in Docket Nos. E-1032-86-020, E-1656-86-020, E-2276-86-020, and E-2334-86-020, Citizens Utilities Company; testimony addressing issues of fair rate of return, capital structure, and prudent utility operations.

Expert witness in Docket No. U-1345-85-156, Arizona Public Service Company; testimony concerning fair rate of return and capital structure, the effects of diversification on APS, APS affiliate relations and tax issues.

Expert witness in Docket No. E-1032-86-020, et al; Citizens Utilities Company; testimony concerning the revenue requirements, operating and accounting practices of Citizens Utilities Water, Wastewater, Electric and Gas Operations in Arizona.

Expert witness in Docket No. E-1032-85-204 et al; Citizens Utilities Rural Company, Inc.; testimony concerning the rate of return and revenue requirements for Citizens Utilities telephone utility operations in Arizona.

Expert witness in Docket No. U-1933-92-101, Tucson Electric Power Company; testimony concerning TEP's requested authorization for restructuring of agreements and the appropriate regulatory policy the Commission should follow as it deals with TEP's continuing restructuring process and the ratemaking impact of that process.

Expert witness in Docket No. U-1933-93-006, Tucson Electric Power Company; testimony concerning TEP's cost of capital and fair rate of return that should be allowed for the purpose of setting electric utility rates and TEP's proposed cost allocation methodology and related rate design proposals.

Before the Arkansas Public Service Commission -

Expert witness in Docket No. 81-144-U, Arkansas Power & Light Company; testimony concerning proposals by AP&L and Commission staff to retroactively allocate to Reynolds Metals a customer-specific charge for unrecovered revenue balance.

Expert witness in Docket No. U-2748, Southwestern Bell Telephone Company; testimony concerning service and equipment costs, tariff structures and competition in the telecommunications industry.

Expert witness in Docket No. U-2896, Generic Hearing; testimony concerning competition in the telecommunications industry.

Expert witness in Docket No. 82-314-0, Arkansas Power & Light Company; testimony concerning cost of service issues.

Expert witness in Docket No. 83-064-U, Southwestern Electric Power Company; testimony concerning rate of return, CWIP and cash working capital issues.

Expert witness in Case No. 84-249-U, Arkansas Power & Light Company; testimony discussing the extent to which the cost of Middle South Utilities Grand Gulf Unit 1 should be included in Arkansas Power & Light Company's rates.

Before the Canadian Radio Television and Telecommunications Commission -

Expert testimony concerning the competitive implications of Canadian Pacific Telecommunication's application for access to the Bell Canada network.

Expert testimony concerning cost methods in Docket No. 1981-41.

Expert testimony concerning the Commission's Revenue Settlement Plan and the cost methodologies presented by Bell Canada and others; the testimony presents a fully distributed cost methodology for application to the major telephone utilities in Canada.

Expert testimony concerning the resale of telecommunication services and the interconnection of competitive long distance carriers to the local networks of telephone companies.

**Newfoundland and Labrador Board of Commissioners of Public Utilities - Canada**

Expert witness in the matter of Newfoundland and Labrador Hydro, testimony and report filed on behalf of Board of Commissioners concerning cost of service methodology, rate design and proposed rates, July 2001.

Expert witness In The Matter of an Amended Application by Petition of Newfoundland Light & Power Co. Limited; testimony on behalf of the Board of Commissioners concerning NL&P cost allocations and proposed rate design, July, 1996.

Report to The Board of Commissioners of Public Utilities of Newfoundland and Labrador concerning Newfoundland Power Company's Study of Rate Designs Based on Marginal Costs.

Report to The Board of Commissioners of Public Utilities of Newfoundland and Labrador, *Regulation of Electric Utility Capital Expenditures: A Summary of North American Jurisdictions*, January 2004.

**The California Earthquake Authority -**

Report to the California Earthquake Authority, *Actuarial Report Regarding the California Earthquake Authority's 2002 Proposed Rate Application*, October 2002.

**Before the California State Insurance Commissioner -**

Expert testimony in File No. REB-1002 (Consolidated); testimony in the Matter of Various Rate Increase Applications and With Respect to Certain Issues Related to the Control, Review and Approval of Insurance Rates Pursuant to Insurance Code Sections 1861.01(a), 1861.05, and Related Laws, March 1990.

Expert testimony in the matter of determination of rate of return, leverage factor, and projected yield for 1989 rate calculations, File No. RCD-2 (Continued Hearings) 1991.

**Report to the California Insurance Department -**

Using Industry Loss Trends to Project Individual Insurer Loss Trends, July 1991.

Before the California Public Utilities Commission -

Expert witness in Application No. 55723, Pacific Telephone & Telegraph Company; testimony concerning the basis and economic implications of cost allocation rate levels, and rate design for various types of telephone equipment and service classifications.

Expert witness in Centrex 10191, Investigation into Rates, Tariffs, and Costs of Centrex Service; testimony concerning service and equipment costs, tariff structures, and competition in the telecommunications industry.

Expert witness in Case No. OII 83 06 01, Western Union; testimony concerning "natural" monopolies and regulatory restrictions in telecommunications systems.

California Office of the Attorney General -

Preliminary Report on 1996 Gasoline and Diesel Fuel Retail Price Increases in California, August, 1996.

Before the Colorado Public Utilities Commission -

Expert witness in Docket No. 1154, 1133, Case No. 5748, Mountain States Telephone & Telegraph Company; testimony concerning Dimension PBX and Com Key tariffs as well as Western Electric pricing practices and impacts on competitors in the interconnect industry.

Expert witness in Docket No. 1067, Case No. 5703, Mountain States Telephone & Telegraph Company; testimony concerning service and equipment costs, tariff structure and competition in the telecommunications industry.

Expert witness in Docket No. 1425, Public Service Company of Colorado; testimony concerning service extension charges.

Expert witness in Docket No. 34444, Public Service Company of Colorado; testimony concerning service extension charges.

Before the Connecticut Department of Public Utility Control -

Expert witness in Docket No. 94-12-13, Investigation Into the Restructuring of the Electric Utility Industry.

Expert witness in the application of the Connecticut Light and Power Company for approval of amended rate schedules, Docket No. 90-12-03.

Expert witness in Docket No. 92-11-11, Connecticut Light & Power Company; testimony concerning CL&P's proposed implementation of "average and excessive" cost allocation methodology and proposed rates.

Expert witness in Docket No. 95-07-05, DPUC Investigation of a Fully Tracking Energy Adjustment Clause for Electric Companies; testimony on behalf of the Office of Consumer Counsel concerning the adoption of an EAC to replace the FAC and GUAC to protect the interests of Connecticut ratepayers and ensure economy and efficiency in energy production and purchasing.

Expert witness in Docket No. 96-01-28, DPUC Review of the Purchased Gas Adjustment Clause; testimony on behalf of the Office of Consumer Counsel to determine whether elimination of adjustment clauses would better achieve regulatory policy goals in the natural gas industry, June, 1996.

Expert witness in Docket No. 99-07-20, Joint Application of Energy East Corp. and Connecticut Energy Corporation for Approval of a Change of Control; testimony filed on behalf of Connecticut Office of Consumer Counsel concerning competitive market issues pertaining to the proposed acquisition of Connecticut Energy Corporation by Energy East Corporation, September, 1999.

Expert witness in Docket No. 99-08-02, Joint Application of Northeast Utilities and Yankee Energy System for Approval of a Change of Control; testimony filed on behalf of Connecticut Office of Consumer Counsel concerning competitive market issues pertaining to the proposed acquisition of Yankee Energy System by Northeast Utilities, October, 1999.

Expert witness in Docket No. 99-08-09, Joint Application of Energy East Corporation and CTG Resources for Approval of a Change of Control; testimony filed on behalf of Connecticut Office of Consumer Counsel concerning competitive market issues pertaining to the proposed acquisition of CTG by Energy East, October, 1999.

Before the Delaware Public Service Commission -

Expert witness in Docket No. 80-9, Delmarva Power & Light Company; testimony concerning class revenue requirements, review of the Company's proposed rates, and incentives in the design of the fuel adjustment tariff.

Expert witness in Docket No. 81-8, Diamond State Telephone Company; testimony concerning affiliated relationship and terminal equipment.

Expert witness in Docket No. 83-12, Diamond State Telephone Company; testimony concerning Company's financial condition and rate of return.

Before the D.C. Public Service Commission -

Expert witness in Formal Case No. 686, Washington Gas Light Company; testimony dealing with cost allocation and rate design issues.

Expert witness in Case No. 729, The C&P Telephone Company; testimony concerning regulatory and economic treatment of tax expenses in establishing revenue requirements.

Expert witness in Case No. 748, Potomac Electric Power Company; testimony pertaining to requested rate increase.

Expert witness in Formal Case No. 768, Washington Gas Light Company; testimony concerning the financial condition of the Washington Gas Light Company.

Expert witness in Formal Case No. 777, Chesapeake & Potomac Telephone Company; testimony dealing with Financial Condition, depreciation and Capital Recovery, and Cost Methods.

Expert witness in Formal Case No. 712, Attrition; testimony dealing with Attrition.

Expert witness in Formal Case No. 785, Potomac Electric Power Company; testimony dealing with company request for rate increase.

Expert witness in Formal Case No. 787, Washington Gas Light Company; testimony concerning WGL's financial condition and revenue increase requirements.

Expert witness in Formal Case No. 869, Potomac Electric Power Company; testimony concerning revenue requirement and rate design issues.

Expert witness in Formal Case No. 951, Office of the Peoples Counsel; testimony examining rates, costs, and competitive issues.

Advice and Comments in Formal Case No. 945, Investigation into Electric Services, Market Competition and Regulatory Practices; on behalf of D.C. Office of People's Counsel, January, 1997.

Expert witness in Formal Case No. 922, Application of Washington Gas Light Company District of Columbia Division for Authority to Increase Existing Rates and Charges for Gas Services; testimony on behalf of the Office of People's Counsel concerning reasonableness of financial assumptions underlying the WGL filing in support of its proposed phase-in of post retirement benefits expense under FAS 106, June, 1997.

Report to the D.C. Office of the People's Counsel on Bell Atlantic's Merger Commitments to the Federal Communications Commission, August, 1997.

Report to the D.C. Office of the People's Counsel; Alternatives to the PEPCO/BG&E Merger.

Expert witness in Formal Case No. 1057, Verizon Washington, DC Inc.,s Competitive Under Price Cap Plan 2007 for the Provision of Local Telecommunicatiions's Services in the District of Columbia on behalf of the D.C. Office of the People's Counsel. January 31, 2008.

**Before the Florida Department of Insurance -**

Expert testimony concerning the underwriting return allowable in establishing workers compensation insurance rates (1984).

Expert witness in the 1986 Workers Compensation Insurance Rate Case; testimony concerning the appropriate rate of return for workers compensation insurers in the State of Florida.

Expert testimony concerning the underwriting return and profit rate that should be established in setting rates for workers compensation insurance in Florida (1985).

Expert witness in 1987 workers' compensation insurance rate case; testimony concerning return and underwriting profit that should be established in setting rates for workers compensation insurance in Florida.

Expert witness in 1988 workers' compensation insurance rate case; testimony concerning rate of return for establishing workers' compensation insurance rates in Florida.

Expert witness in 1989 workers' compensation insurance rate case; testimony concerning rate of return for establishing workers' compensation insurance rates in Florida.

Expert witness in an Application of National Counsel on Compensation Insurance for Revision of Workers Compensation Insurance Rates, October 1989.

Expert Witness in the Application of National Counsel on Compensation Insurance for Revision of Workers Compensation Insurance Rates, October 1991.

**Before the Florida Public Service Commission -**

Expert witness in Docket No. 810035TP, Southern Bell Telephone & Telegraph Company; testimony concerning revenue adjustment to achieve the full normalization of deferred tax expenses and the associated current tax costs.

Expert witness in Docket No. 810095-TP, General Telephone Company; testimony dealing with tax normalization issues.

Expert witness in Docket No. 810235-TP, Central Telephone Company of Florida; testimony dealing with deregulation of telephone terminal equipment.



Expert witness in Docket No. 900202-EU, City Electric System of the Utility Board of the City of Key West, Florida; testimony concerning the critical economic importance of coordination in the electric utility industry.

Expert witness in Docket No. 020233-EI, Review of GridFlorida Regional Transmission Organization (RTO) Proposal; testimony concerning prudence of GridFlorida market design principles, October, 2002.

Before the Public Service Commission of Georgia -

Expert witness in Docket No. 3231-U, Southern Bell Telephone & Telegraph Company; testimony concerning its relationship with AT&T with respect to general services and licenses, and the proper treatment of the costs involved.

Expert witness for the Commission's Advisory Staff in Docket No. 18300-U, Georgia Power Company's 2004 Rate Case, testimony on cost of service methodology and rate design, October 2004.

Before the Georgia Department of Insurance -

Report to the Department of Insurance on NCCI's 1992 rate filing regarding appropriate rate of return and underwriting profit and contingency factor that should be allowed in establishing workers compensation insurance rates.

Expert witness in Case No. 93C-147, National Council on Compensation Insurance, audit report of NCCI's 1993 voluntary and residual market workers compensation insurance rate filings and recommendation on appropriate rate of return and required underwriting profit and contingency factor that should be allowed in establishing workers compensation insurance rates.

Before the Hawaii Public Utility Commission -

Expert witness in Docket No. 4125, Citizens Electric Company - Kauai Electric Division; testimony concerning rate of return, capital structure and related issues.

Expert witness in Docket No. 4156, Maui Electric Company, Ltd.; testimony concerning rate of return and related issues.

Expert witness in Docket No. 4306, Hawaii Telephone & Telegraph Company; testimony on overall financial health and revenue requirements.

Expert witness in Docket No. 4588, Hawaiian Telephone Company; testimony on cost-based telephone utility rates and flat customer access charges.

Expert witness in Docket No. 5114, Hawaiian Telephone Company; testimony concerning interstate rate increases and revised rate schedules.

Expert witness in Docket No. 6801, GTE Hawaiian Telephone Company; testimony concerning cost of capital impacts of GTE Corporation and HTC reorganization.

Before the Idaho Public Utilities Commission -

Expert witness in Case U-1000-37, Mountain States Telephone & Telegraph Company; testimony concerning rate of return, capital structure and related issues.

Before the Illinois Commerce Commission -

Expert witness in Docket No. 77-0511, Illinois Bell Telephone Company; testimony concerning proposed trunk rates and regulations.

Expert witness in Docket No. 85-0079, Continental Telephone Company of Illinois; testimony concerning proposed general increases in telephone rates.

Expert witness in Docket Nos. 83-0573 and 84-0555, Commonwealth Edison Company; testimony on behalf of the Attorney General of the State of Illinois concerning a phase-in of new rates for Commonwealth Edison.

Expert witness in Docket No. 84-0111, Illinois Bell Telephone Company; testimony concerning the proposed restructuring of Centrex services applicable in all exchanges.

Expert witness in Docket No. 87-0427, Commonwealth Edison Company; testimony concerning cost of capital and rate of return issues for the purpose of setting electric utility rates.

Expert witness in Docket No. 90-0169, Commonwealth Edison Company; testimony concerning cost of capital and rate of return issues for the purpose of setting electric utility rates.

Before the Indiana Public Service Commission -

Expert witness in Cause No. 35214, Public Service of Indiana, Inc.; testimony concerning cost allocation, rate design issues and the economic implications of electric utility rates.

Expert witness, Cause No. 35214, Public Service Company of Indiana; testimony concerning rate structure design and cost allocation issues.

Expert witness in Cause No. 37558, Indiana Bell Telephone Company, Inc.; testimony concerning the authority to make adjustments in the existing Centrex exchange and network services rates, for approval of new schedules, rates, and rules and regulation.

**Before the Iowa State Commerce Commission -**

Expert witness in Docket No. RPU-84-7, Northwestern Bell Telephone Company; testimony concerning the adjustment of intrastate rates and charges.

Expert witness in Docket No. RPU-84-40 (RF-84-305), Iowa-Illinois Gas and Electric Company; testimony on behalf of North Star Steel concerning the appropriateness of the proposed revision to Rider 4 for interruptible service.

Expert witness in Docket No. RPU-86-8, Interstate Power Company; testimony concerning the implementation of management efficiency standards in the regulatory process.

**Before the Iowa Utilities Board -**

Expert witness for the Office of Consumer Advocate in Docket No. RPU-05-2-TF-05-143 and TF-05-144; Aquila, Inc. d/b/a Aquila Networks regarding the Management Performance of Aquila, Incorporated and the potential of this performance on Iowa gas utility ratepayers. August 2005.

Expert witness for the Office of Consumer Advocate in Docket RPU-08-3; Black Hills/Iowa Gas Utility Company, LLC d/b/a Black Hills Energy (f/k/a Aquila, Inc, d/b/a Aquila Networks. December 3, 2008.

Expert witness for the Office of Consumer Advocate in Docket No. RPU-2010-0001, Interstate Power and Light Company. Testimony - July 2010.

**Idaho Tax Commission -**

Expert advice and analysis in valuing Electric Utility Property. Report Valuing Electric Utility Property prepared and presented to the Idaho State Tax Commission, and testimony in property tax proceedings for Idaho Power Company and PacifiCorp. June 2005.

**Before the State Corporation Commission of the State of Kansas-**

Expert witness in Docket Nos. 105, 712-U, Southwestern Bell Telephone Company; testimony dealing with service and equipment costs, tariff structures and competition in the telecommunications industry.

Expert witness in Docket No. 97-WSRE-676-MER, Joint Application of Western Resources, Inc. and Kansas City Power and Light Company for Approval of Merger and Other Related Relief; testimony filed on behalf of Kansas City Board of Public Utilities regarding merger related market power issues, February, 1999.

Before the District Court of Montgomery County, Kansas –

Expert witness in Case No. 09 CV 691, Coffeyville Resources Nitrogen Fertilizers, LLC vs. City of Coffeyville, Kansas, August 2010

Before the Utility Regulatory Commission of Kentucky -

Expert witness in Case No. 7669, General Telephone Company of Kentucky; testimony concerning an adjustment in rates.

Expert witness in Case No. 9160, South Central Bell Telephone Company; testimony concerning an increase in rates and the approval of tariff changes for telecommunications service.

Expert witness in Case No. 8847, South Central Bell Telephone Company; testimony concerning financial condition, rate base and rate of return.

Before the Louisiana Insurance Rating Commission -

Expert witness in the Matter of Workers Compensation Insurance Rates 1986; testimony concerning loss development, expense trending and financial matters pertaining to the specification of an appropriate rate level for workers compensation insurance in Louisiana.

Before the Louisiana Public Service Commission -

Expert witness in Docket No. U-14495, Gulf States Utilities Company; testimony concerning price elasticity of demand for electric utility service.

Before the Maine Public Utilities Commission -

Expert testimony in F.C. #2168, Central Maine Power Company; testimony concerning electric utility rate structure design.

Expert witness in Docket No. F.C. 2332, Central Maine Power Company; testimony dealing with rate design issues and the economic implications of electric utility rates.

Expert witness in Docket No. 80-142, New England Telephone & Telegraph Company; testimony concerning proposed increase in rates.

Expert witness in Docket No. 80-108, Bangor Hydro-Electric Company; testimony concerning cost of serving an interruptible customer.

Expert witness in Docket No. 80-66, Central Maine Power Company; testimony concerning cost of service and rate design issues.

Before the Maine Bureau of Insurance -

Expert witness in the Matter of Workers Compensation Insurance Rates; testimony concerning loss development, expense trending, investment income and other matters pertaining to the appropriate level of workers compensation insurance rates in Maine.

Expert witness in Docket No. INS-88-2, National Counsel on Compensation Insurance; testimony concerning earnings rate and underwriting return for establishing workers' compensation insurance rates in Maine.

Expert witness in Docket No. INS-91-66; testimony concerning appropriate profit and contingency component for inclusion in the servicing carrier allowance for workers compensation rates.

Before the Maryland Public Service Commission -

Expert testimony in Case No. 6807, Future Adequacy of Service; testimony concerning electric power demand modeling and forecasting.

Expert witness in Case No. 7338, Phase III, Potomac Edison Company; testimony concerning electric utility rate design pertinent to the Public Utility Regulatory Policies Act of 1978.

Expert witness in Case No. 7408, Baltimore Gas & Electric Company; testimony concerning BG&E's Gas Service Tariff provisions regarding the costs to be paid by new customers for gas main extensions and service line extensions in excess of 50 feet.

Expert witness in Case No. 7435, Chesapeake & Potomac Telephone Company; testimony concerning capital cost issues.

Expert witness in Case No. 7450, Chesapeake & Potomac Telephone Company; testimony concerning issues related to the divestiture by AT&T.

Expert witness in Case No. 7450 Phase II/7735, Chesapeake & Potomac Telephone Company; testimony concerning cost of service and subscriber access costs.

Expert witness in Case No. 7851, Chesapeake & Potomac Telephone Company; testimony concerning the application for authority to restructure schedule of rates and charges.

Expert witness in Case No. 7467, The Chesapeake & Potomac Telephone Company; testimony concerning the regulatory and economic treatment of deferred tax expenses and credits in establishing revenue requirements.

Expert witness in Case No. 7591, Chesapeake & Potomac Telephone Company; testimony dealing with cost methods.

Expert witness in Case No. 7661, Chesapeake & Potomac Telephone Company; testimony concerning the development of cost of service methodologies.

Before the Utilities Commission of St. Michaels, MD -

Expert witness in annual rent arbitration; testimony concerning fair and reasonable revised annual rent for period 10/15/91 to 10/15/96 to be paid by Delmarva Power & Light Company under its 1981 lease of the St. Michaels service territory.

Before the Massachusetts Public Utility Commission -

Expert witness in D.P.U. 19139, Investigation of Rates and Charges for Dimension 400 PBX Service; testimony concerning service and equipment costs; tariff structures and competition in the telecommunications industry.

Expert witness in Docket No. D.P.U. 84-25, Western Massachusetts Electric Company; testimony concerning CWIP in rate base, cash flow and phase-in issues.

Before the Commonwealth of Massachusetts Division of Insurance -

Expert witness in Docket No. 2001-29, Automobile Insurance Bureau of Massachusetts, testimony filed on behalf of the Massachusetts Attorney General concerning cost of capital and rate of return, September 2001.

Expert witness in Docket No. 2000-10, Automobile Insurance Bureau of Massachusetts, testimony filed on behalf of The Massachusetts Attorney General concerning private passenger automobile insurance rates and underwriting profit, August 2000.

Expert witness in Application of Automobile Insurance Bureau of Massachusetts, 2000 Massachusetts Private Passenger Automobile Underwriting Profit Filing; testimony filed on behalf of Massachusetts Attorney General concerning rate of return and cost of capital, September, 1999.

Before the Michigan Public Service Commission -

Expert witness for the State of Michigan, Department of Attorney General in Case Nos. U-5365 and U-5322, Michigan Consolidated Gas Company; testimony concerning rate of return and cost of service issues.

Expert witness in Case No. U-5502, Detroit Edison Company; testimony concerning rate of return.

Expert witness of the State of Michigan, Department of Attorney General in Case No. U-5608, Indiana & Michigan Electric Company; testimony concerning rate of return.

Expert witness for the State of Michigan Office of Attorney General in Case No. U-5669, Upper Peninsula Power Company; testimony concerning rate of return and cost of service issues.

Expert witness in Case U-5955, Michigan Consolidated Gas Company; testimony concerning rate of return and capital structure issues.

Expert witness in Case U-6002, Michigan Bell Telephone Company; testimony concerning capital structure and rate of return issues.

Expert witness in Case U-5979, Consumer's Power Company; testimony concerning rate of return issues.

Expert witness in Cases U-5197, U-5752, U-5753 and U-5754, Michigan Bell Telephone Company; testimony concerning cost of service and antitrust issues.

Expert witness in Docket No. U-6103, Detroit Edison Company; testimony concerning cost of service and steam heat rates.

Expert witness in Cause No. U-7660, Detroit Edison Company; testimony concerning financial conditions, revenue requirements and cash flow issues.

Expert witness in Cause No. U-7830, Consumers Power Company; testimony concerning capital structure and rate of return as well as revenue requirement issues pertaining to the Midland plant.

Expert witness in Case No. U-8789, The Detroit Edison Company; testimony concerning costs of excess capacity in setting utility rates in regard to proper ratemaking treatment for the FERMI 2 plant.

Expert witness in Case No. U-10127 and U-8871, Consumers Power Company; testimony concerning the merits of CPCo's proposed settlement agreement to resolve Midland Cogeneration Venture Limited Partnership cost recovery issues.

Before the Michigan Department of Commerce, Insurance Bureau -

Expert witness in Case No. 91-11806-BC, Blue Cross Blue Shield of Michigan; testimony concerning required rate levels for BCBSM.

Before the Minnesota Commerce Commission -

Expert witness in O.A.H. Docket No. 9-1004-3412-2, St. Paul Fire & Marine Insurance Company; testimony concerning required return, profit and contingency

factor, expense level, loss ratio and resulting rate change that should be implemented in establishing St. Paul's rates for physicians and surgeons medical malpractice liability insurance in Minnesota.

**Before the Minnesota Public Service Commission -**

Expert cost of service and rate design witness in Docket No. E-002/GR-77-611, Northern States Power Company; testimony concerning cost responsibility, cost allocation, and principles of rate structure design.

Expert cost of service and rate design witness in Docket No. E002/GR-76-934, Northern States Power Company; testimony concerning cost responsibility and cost allocation issues and principles of rate structure design.

Expert rate design witness in Docket No. ER-2-1, Northern States Power Company; testimony involved analysis of rate design issues including time-of-day pricing, marginal cost responsibility, and load factor analysis.

Expert witness in Docket No. G-008/GR-77-1237, Minnesota Gas Company; testimony concerning cost allocation and rate of return issues.

**Before the Mississippi Public Service Commission -**

Expert witness in Docket No. U-3929, Mississippi Power Company; testimony concerning proposed increase in rates. and recommendations to a fair rate of return in electric utility rates.

**Before the Missouri Public Service Commission -**

Expert witness in Docket No. TR82-1998, Southwestern Bell Telephone Company; testimony concerning rate of return requirements.

Expert witness in Case No. TR-83-253, Southwestern Bell Telephone Company; testimony concerning cost of service and subscriber access costs.

Expert witness in Case No. EM-96-149, Application of Union Electric Company for an Order Authorizing (1) Certain Merger Transactions Involving Union Electric Company; (2) the Transfer of Certain Assets, Real Estate, Leased Property, Easements and Contractual Agreements to Central Illinois Public Service Company; and (3) in Connection therewith, Certain Other Related Transactions; testimony filed on behalf of the PSC concerning merger related market power issues, November, 1996.



Before the Missouri Department of Insurance -

Expert witness in Case No. 93-06-09-0621, Modern American Life Insurance Company; affidavit concerning MAL's proposed reorganization and its effect on policyholders.

Before the Montana Public Service Commission -

Expert witness for the Commission Staff in Docket No. 6279, Montana Power Company; testimony concerning rate structure design, cost of service issues, and rate of return.

Expert witness for the Commission Staff in Docket No. 6277, Montana-Dakota Utilities Company; testimony concerning rate of return, rate structure design, and cost of service issues.

Expert witness for the Commission Staff in Docket No. 6441, Montana-Dakota Utilities Company; testimony concerning rate of return issues.

Expert witness for the Consumer Counsel in Docket No. 6454, Montana Power Company; testimony concerning rate of return.

Expert witness for the Consumer Counsel in Docket No. 6496, Mountain States Telephone and Telegraph Company; testimony concerning rate of return and cost of capital.

Expert witness for the Consumer Counsel in Docket No. 6494 and 6495, Butte Water Company; testimony dealing with rate of return and cost of service issues.

Expert witness in Docket Nos. 6545 and 6546, Montana Power Company Water Rates; testimony concerning proposed water rate increases. (Rate of return and cost of service issues.)

Expert witness for the Consumer Counsel in Docket No. 6567, Montana-Dakota Utilities Company; testimony concerning rate of return, cost allocation, and rate design issues.

Expert witness in Docket No. 6618, Phase I and Phase II, Montana Power Company; testimony concerning rate of return, capital structure, and gas utility rate structure design issues.

Expert witness for the Consumers' Counsel in Docket No. 6701, Great Falls Gas Company; testimony concerning cost of service, cost allocation, and rate design issues.

Expert witness for the Consumer's Counsel in Docket No. 6695, Montana-Dakota Utilities Company; testimony concerning gas and electric rate design and testimony concerning the profits earned by an affiliated coal company.

Expert witness in Docket No. 80.4.2, Montana Power Company; testimony concerning cost of capital and rate of return.

Expert witness in Docket No. 80.7.52, Montana-Dakota Utilities Company; testimony concerning revenue adjustment and the associated current tax costs, and recommendations concerning gas utility rate design.

Expert witness in Docket No. 80.10.79, Mountain States Telephone & Telegraph Company; testimony concerning pro-posed rate changes and rate structure recommendations.

Expert witness in Docket No. 80.12.100, Mountain States Telephone & Telegraph Company; testimony concerning revenue adjustment and the associated current tax costs, and treatment of affiliate relationship costs.

Expert witness in Docket No. 81.1.2, Montana-Dakota Utilities Company; testimony concerning revenue adjustment and the associated current tax costs, the profits earned by an affiliated coal company, and electric rate structure design.

Expert witness in Docket No. 81.8.70, Pacific Power & Light Company; testimony on rate design and excess coal profits.

Expert witness in Docket No. 82.2.8, Mountain States Telephone Company; testimony dealing with financial conditions and rate of return.

Expert witness in Docket No. 82.4.28, Pacific Power and Light Company; testimony concerning the issues of coal profit levels and an "attrition" adjustment.

Expert witness on Docket No. 82.8.54, Montana Power Company; testimony dealing with utility captive coal profits and revenue increase needs.

Expert witness in Docket No. 83.3.18, Mountain States Telephone & Telegraph Company; testimony concerning cost of service and access charge matters.

Expert witness in Docket No. 83.3.18, Mountain States Telephone & Telegraph Company; testimony concerning cost of capital, rate of return, and cost of service issues.

Reply Comments on Telephone Access Costs and Rates in Docket No. 83.6.47.

Expert witness in Docket No. 83.5.36, Pacific Power and Light Company; testimony concerning coal profit levels.

Expert witness in Docket No. 83.9.67, Montana Power Company; testimony concerning coal profit levels and cost allocation and rate design issues.

Expert witness in Docket No. 83.9.68, Montana-Dakota Utilities Company; testimony concerning coal purchases and operations.

Expert witness in Docket No. 83.11.80, AT&T Communications of the Mountain States, Inc.; testimony concerning the Company's financial circumstances, its forecasted budgeted test year, access charges, and the rate of return to be included in the rate for intrastate toll services.

Expert witness in Utility Division Docket No. 84.10.64, in the matter of the Commission's Investigation of Electric Avoided Cost. Testimony presented on behalf of the Montana Consumer Counsel concerning a range of alternative methods of determining the avoided cost of Montana jurisdictional utilities that should be applied in setting rates payable to cogenerators and qualifying facilities.

Expert witness in Case No. 84.4.19, Mountain States Telephone and Telegraph Company; testimony deals with the Company's financial circumstances, its forecasted budgeted test year, directory revenues and expenses, productivity, official services, cash working capital and the rate of return which should be included in the telephone service rates.

Expert witness in Docket No. 87.12.77, The Montana-Dakota Utilities Company; testimony concerning as utility rate design.

Expert witness in Docket No. 88.1.2, Mountain States Telephone & Telegraph Company; testimony concerning rate of return to support MBT's telephone utility service in Montana.

Expert advice and analysis in the matter of the application for approval of (A) the general filing of Pacific Power and Light Company in demonstration of one test year as a merged company and (B) proposed new tariff, Schedule No. 47T, on the PP&L Champion International Inc. Electric Service Contract, Utility Division Docket No. 90.11.78.

Advice and analysis in the matter of the application of U S West Communications Inc. for approval of an alternative form of regulation, et al., Docket Nos. 90.12.86, 89.8.28, 89.8.29, 89.9.29, 90.5.32.

Expert witness in Docket No. 91.3.12, GTE Northwest, Inc.; testimony concerning required rate of return allowance to support GTE-NW's jurisdictional telephone utility service.

Expert witness in Docket No. 92.7.32, PTI Communications; testimony concerning rate of return allowance that PTIC requires to support its jurisdictional telephone utility service rate base.

Expert witness in Docket No. 93.3.10, Order No. 5701a; testimony concerning a Commission investigation of standards of the Energy Policy Act of 1992 and whether adoption of standards would carry out the purpose of Title I of the Public Utility Regulatory Policies Act of 1978.

Expert witness in Docket No. 93.6.24, Montana Power Company; testimony concerning rate requirements, regulatory policy issues, and restrictions on profits in dealings with affiliates.

Expert witness in Docket No. 93.7.29, Montana Power Company; testimony concerning cost allocation and rate design.

Expert witness in Docket No. D2001.10.144, Montana Power Company; testimony concerning MPC's electric default supply portfolio filing and proposed tariffs and rate changes, January, 2002.

Expert advice and analysis in Docket No. D2002.7.93; comments concerning Commission's Inquiry into Necessary and Reasonable Rates for Default Electric Supply Service, August, 2002.

Expert advice and analysis in Docket No. D2003.8.109 concerning Investigation of NorthWestern Energy's Financial and Related Transactions with NorthWestern Corporation, its Affiliates and Creditors that May Impair its Financial Solvency and Public Utility Service Obligations, August 2003.

Expert witness for the Montana Consumer Counsel in Docket No. D2004.3.45; the Application of North Western Energy for Approval of Agreement for Sale and Purchase of Capacity and Energy between North Western Energy and Basin Creek Equity Partners, LLC, June 2004.

Direct Testimony in Docket No. D2003.6.77 and D2004.6.90 Utility Division, Northwestern Energy's Electric Default Supply Tracker Filings for the periods of July 1, 2002 through June 30, 2003 and July 1, 2003 through June 30, 2004 and for the Forecasted Period July 1, 2004 through June 30, 2005. December 13, 2004

Direct Testimony on behalf of the Montana Consumer Counsel In the Matter of the Joint Application of NorthWestern Corporation and Babcock & Brown Infrastructure Limited, BBI US Holdings Pty Ltd., BBI US Holdings II Corp., and BBI Glacier Corp. For Approval on the Sale and Transfer of NorthWestern Corporation Pursuant to a Merger Agreement. Docket No. D2006.6.82 December 15, 2006.

Expert witness for the Montana Consumer Counsel. Direct Testimony In the Matter of NorthWestern Energy's Electric Default Supply Tracker Filings for the Periods July 1, 2005 through June 30, 2006 and July 1, 2006 through June 30,

2007 and for the Forecasted Period July 1, 2007 through June 30, 2008. Docket Nos. D2006.5.66 and D2007.5.46. October 5, 2007.

Expert witness for the Montana Consumer Counsel. Direct Testimony In the Matter of Montana-Dakota Utilities Co., Application for Authority to Establish Increased Rates for Electric Service. Docket No. D2007.7.79. October 22, 2007.

Expert witness for the Montana Consumer Counsel. Testimony In the Matter of NorthWestern Energy's Application for Authority to Establish Increased Natural Gas and Electric Service Rates. Docket No. D2007.7.82. November 9, 2007

Expert witness for the Montana Consumer Counsel. Direct Testimony In the Matter of An Investigation of NorthWestern Corporation Compliance with Order 6505e. Docket No. D2008.4.36. May 20, 2008.

Expert witness for the Montana Consumer Counsel. Testimony In the Matter of NorthWestern Energy's Application for Authority to Establish Increased Natural Gas and Electric Service Rates. Phase II. Docket No. D2007.7.82. July 18, 2008.

Direct Testimony In the Matter of the Application of NorthWestern Energy for Approval to Construct and Operate the Mill Creek Generating Station to Supply Regulation Service for NorthWestern Energy's Montana Electric Operations and Montana Transmission Control Area Docket No. D2008.8.95. November 20, 2008.

Direct Testimony on behalf of the Montana Consumer Counsel In the Matter of the Petition of Energy West Incorporated for an Order Approving Its Corporate Reorganization to Create a Holding Company Structure; Docket No. D2008.5.57; January 29, 2009.

Testimony on behalf of the Montana Consumer Counsel In the matter of the Application of Energy West Incorporated for Approval of its Acquisition of And Transfer of Stock of Brainard Gas Corporation, Great Plains Natural Gas Company, Lightning Pipeline Company, Inc. and Membership Interest in Great Plains Land Development Co., Ltd. Docket No. D2008.11.132, April 17, 2009.

Direct Testimony on behalf of the Montana Consumer Counsel In the matter of NorthWestern Energy's Electric Supply Tracker Filings for the Periods July 1, 2007 through June 30, 2008 and July 1, 2008 through June 30, 2009 and for the Forecasted Period July 1, 2009 through June 30, 2010. Docket Nos. D2008.5.45 and D2009.5.62.

Testimony on behalf of the Montana Consumer Counsel In the matter of the Application of Mountain Water Company for Authority to Increase Rates and Charges for Water Service to its Missoula, Montana Customers. Docket No. D2010.4.41, Order No. 7088, October 15, 2010.

Direct Testimony on behalf of the Montana Consumer Counsel In the matter of NorthWestern Energy's Application for Approval of Avoided Cost Tariff For New Qualifying Facilities. Docket No. D2010.7.77, November 10, 2010.

Direct Testimony on behalf of the Montana Consumer Counsel In the matter of the Application of Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc. for Authority to Establish Increased Rates for Electric Service. Docket No. D2010.8.82, December 23, 2010.

Direct Testimony on behalf of the Montana Consumer Counsel In the matter of the Application of Energy West Montana to Establish Increased Service Rates in the Great Falls, Cascade and West Yellowstone Service Areas. Docket No. D2010.9.90, April 12, 2011.

Direct Testimony on behalf of the Montana Consumer Counsel In the matter of the Consolidated Petition by Mountain Water Company for Declaratory Rulings and Application for Approval of Sale and Transfer of Stock in Park Water Company. Docket No. D2011.1.8, July 29, 2011.

Compliance Direct Testimony on behalf of the Montana Consumer Counsel In the matter of the Application of Northwestern Energy for Approval to Construct and Operate the Mill Creek Generating Station to Supply Regulation Service for Northwestern Energy's Montana Electric Operations and Montana Transmission Control Area. Docket No. D2008.8.95, August 12, 2011.

Direct Testimony on behalf of the Montana Consumer Counsel In the matter of the Application of NorthWestern Energy for Approval to Purchase and Operate the Spion Kop Wind Project, for Certification of the Spion Kop Wind Project as an Eligible Renewable Resource, and for Related Relief. Docket No. D2011.5.41, September 22, 2011.

Before the State of Montana Tax Appeal Board –

Expert witness in the matter of PPL Montana, LLC v. Montana Department of Revenue. Cause No. DV-STP-2002-4 (Report – April 2004).

Expert witness in Case No. SPT-2006- NorthWestern Corporation v. State of Montana, Department of Revenue. Economic Critique of the Shaw Stone & Webster Appraisal. December 2006.

Expert witness in the matter of PacifiCorp v. State of Montana Department of Revenue. Cause No. CT-2005-3.

Expert witness. The Value of Puget Sound Energy, Inc.'s Electric and Gas Property An Economic Critique of the Davis Appraisal And the Cornia/Walters Obsolescence Analysis. April 2008.

Before the Montana Thirteenth Judicial District Court -

Expert witness in Cause No.: DV-10-1312, Bresnan Communications, LLC vs. State of Montana Department of Revenue. Report dated July 2011, Affidavit September 1, 2011.

Before the Nebraska Public Service Commission -

Expert witness in Docket No. C-227, Northwestern Bell Telephone Company; testimony concerning rate of return and capital structure issues.

Before the Nevada Public Service Commission -

Expert witness in Docket No. 83-707, Nevada Power Company; testimony concerning cost of common equity and rate of return.

Before the New Hampshire Public Utilities Commission -

Expert witness in Docket No. DG 10-017, EnergyNorth Natural Gas; testimony concerning cost of common equity and rate of return. October 22, 2010.

Direct Testimony on behalf of the Commission Staff in Docket No. DG 10-055 Unitil Energy Systems, Incorporated; testimony concerning rate of return and cost of common equity. November 5, 2010.

Before the New Jersey Department of Public Utilities -

Expert witness in PUC Docket Number 7512-1314. New Jersey Bell Telephone Company; testimony concerning service and equipment costs, tariff structures and competition in the telecommunications industry.

Expert witness in Docket No. 8312-1126, Western Union; testimony concerning competition in intrastate telecommunications.

Expert testimony concerning whether the provision of telecommunications service is a "natural monopoly," whether regulatory restrictions should be imposed in order to maintain monopoly conditions, and the extent to which monopolized interexchange service permits subsidies to local exchange service.

Before the New Jersey Insurance Department -

Expert witness in Rate Counsel File No. 83-PPA-6, Keystone Insurance Company; testimony concerning the underwriting return on private passenger automobile insurance rates and loss/expense projections.

Expert witness in File No. 83-30, Reliance Insurance Company; testimony concerning the underwriting return on private passenger automobile insurance rates and loss/expense projections.

MIC Insurance Company; expert testimony concerning the underwriting return that should be allowed in establishing MIC's private passenger automobile insurance rates in New Jersey.

Expert witness in Department of Insurance Filing Nos. 86-847 and 86-1964, Prudential Property and Casualty Insurance Company; testimony concerning the appropriate underwriting margins for Prudential's automobile liability and physical damage coverage in New Jersey.

Expert witness in DOI Filing No. 87-1725, State Farm Mutual Automobile Insurance Company; testimony concerning earnings rate, expense level and underwriting return for establishing private passenger automobile insurance rates in New Jersey.

Expert witness in DOI Filing No. 87-1845, The Prudential Property and Casualty Insurance Company; testimony concerning earnings rate, expense level and underwriting return for establishing private passenger automobile insurance rates for Prudential in New Jersey.

Expert witness in DOI Filing No. 88-188, Liberty Mutual Fire Insurance Company; testimony concerning earnings rate, expense level and underwriting return for establishing private passenger automobile insurance rates for Liberty Mutual in New Jersey.

Expert witness in DOI Filing No. 88-211, Colonial Penn Insurance Company; testimony concerning earnings rate, expense level and underwriting return for establishing private passenger automobile insurance rates for Colonial Penn in New Jersey.

Expert witness in DOI File No. 88-1736, The Prudential Property and Casualty Insurance Company; testimony concerning earnings rate, expense level and the underwriting return for establishing private passenger automobile insurance rates for Prudential in New Jersey.

Before the New Mexico Corporation Commission -

Expert witness in Docket No. 1002, Mountain States Telephone & Telegraph Company; testimony concerning cost of service allocation issues.

Before the New York Public Service Commission -

Expert witness for Suffolk County in Case No. 27136, Long Island Lighting Company; testimony dealing with rate of return and cost of service issues.

Presentation regarding telephone customer access line charges and bypass before an en banc meeting of the Public Service Commission, March 1984.



Expert witness in Case No. 27006, New York Telephone Company; testimony concerning service and equipment costs, tariff structure and competition in the telecommunications industry.

Expert witness in Cases 26943, 26944, 26945, Niagara Mohawk Power Corporation; testimony concerning electric utility costs and rate structure design.

Expert witness in Cases 27374 and 27375, Long Island Lighting Company; testimony concerning electric and gas rate issues.

Expert witness in Docket No. 27774, Long Island Lighting Company; testimony concerning electric utility rate structure design.

Expert witness in Case 27469, New York Bell Telephone Company; testimony concerning terminal equipment rates. Affidavit dealing with the legality of tariffs filed by the Rochester Telephone Corporation.

Expert witness in Case No. 28954, Consolidated Edison Company of New York; testimony concerning claimed revenue requirements regarding capital structure.

Expert witness in Case No. 28978, New York Telephone; testimony presents the theoretical foundations for an appropriate Centrex rate structure and rates.

Expert witness in Case Nos. 90-E-1185 and 90-G-0112, Long Island Lighting Company; testimony addressing ratemaking issues concerning LILCO's proposed "sales adjustment mechanism, insurance costs, advertising expenditures, and Edison Electric Institute (EEI) dues." (May 1991)

Expert witness in Case No. 96-E-0132, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations for Long Island Lighting Company for Electric Service to Determine if Opportunities Exist to Reduce Electric Prices; testimony filed on behalf of LIPA concerning LILCO's required rate of return on rate base, August, 1996.

Before the North Carolina Utility Commission -

Expert witness for the Commission Staff in Docket No. E-22, Sub 224, Virginia Electric & Power Company; testimony concerning rate of return.

Expert witness for the Commission Staff in Docket No. E-7, Sub 237, Duke Power Company; testimony concerning rate of return.

Expert witness for the Commission Staff in Docket No. P-55, Sub 816, Southern Bell Telephone Company; testimony concerning rate of return and capital structure issues.

Expert witness in Docket No. P100, Sub 65, on behalf of the North Carolina Department of Justice, testimony concerning telephone access charges.

Expert witness in Docket No. E-7, Sub 373, Duke Power Company; testimony concerning rate base and cost of service issues.

Expert witness in Docket No. E-7, Sub 391, Duke Power Company; testimony concerns required rate of return and cost of capital.

Expert witness in Docket No. P55, Sub 834, Southern Bell Telephone and Telegraph Company; testimony concerning attrition adjustment, rate of return, and divestiture related revenue requirement issues.

Expert witness in Docket No. E-2, Sub 503, Carolina Power & Light Company; testimony pertains to application for authority to adjust and increase electric rates.

Expert witness in Docket Nos. E-2, Sub 391; E-2, Sub 416; E-2, Sub 402; E-2, Sub 411; E-2, Sub 446, Carolina Power & Light Company; testimony presents an independent analysis of the appropriateness of the fuel factors employed by Carolina Power & Light Company.

Expert witness to Docket No. E-2, Sub 481, Carolina Power & Light Company; testimony concerns the amounts of CWIP included in CP&L's rate base.

Expert witness in Docket E-100, Sub 41A, testimony addressing the biennial determination of rates for sale and purchase of electricity between utilities and qualifying facilities.

Expert witness in Docket No. E-2, Sub 481, Carolina Power & Light Company; testimony addresses the necessity for the requested rate relief.

Expert witness in Docket No. E-7, Sub 408; Duke Power Company; testimony concerning the expense, rate base and rate of return issues pertaining to Duke's request for an increase in retail electric rates.

Before the North Carolina Insurance Commission -

Expert witness on behalf of the North Carolina Insurance Department in Docket No. 361, concerning private passenger automobile insurance rates filed by the North Carolina Insurance Service office.

Expert witness pertaining to the earnings rate that should be allowed in establishing private passenger automobile insurance rates.

Expert witness pertaining to the underwriting return that should be allowed in establishing farmowners multiple peril insurance rates.

Expert witness in Docket No. 474; testimony concerning the appropriate rate of return and underwriting margin for automobile insurers in North Carolina.

Expert witness before the Commissioner of Insurance; testimony concerning the allowable underwriting return in farmowners multiple peril insurance rates.

Expert witness in 1987 private passenger automobile insurance rate case; testimony concerning earnings rate and underwriting return for establishing private passenger automobile insurance rates in North Carolina.

Expert witness in 1987 workers' compensation insurance rate case; testimony concerning earnings rate and underwriting return for establishing workers' compensation insurance in North Carolina.

Expert witness in 1988 private passenger automobile insurance rate case; testimony concerning earnings rate and underwriting return for establishing private passenger automobile insurance rates in North Carolina.

Expert witness in 1989 private passenger automobile insurance rate case; testimony concerning earnings rate and underwriting return for establishing private passenger automobile insurance rates in North Carolina.

Expert witness in Docket No. 478; testimony concerning dividends, deviations, accounting principles, and premium-to-surplus ratios are appropriate in determining rates.

Expert witness in Docket No. 535, North Carolina Rate Bureau; testimony regarding a revision of Private Passenger Automobile Insurance Rates, October 1989.

Expert witness, North Carolina Rate Bureau 1992 filing, testimony concerning appropriate rate of return on the underwriting profit and contingency factor that should be allowed in establishing workers compensation rates.

Expert witness concerning the appropriate rate of return and underwriting profit and contingency factor that should be allowed in establishing private passenger automobile insurance rates.

Expert witness in Docket Nos. 670 & 671; North Carolina Rate Bureau 1993 filing, testimony concerning appropriate rate of return and underwriting profit and contingency factor that should be allowed in establishing homeowners and dwelling fire and extended coverage insurance rates.

Expert witness in Docket No. 689, North Carolina Rate Bureau 1994 filing; testimony concerning appropriate rate of return and underwriting profit and contingency factor that should be allowed in establishing private passenger automobile insurance rates.

Before the Public Utilities Commission of Ohio -

Expert witness in Case No. 99-1212-EL-ETP, First Energy Corporation; testimony filed on behalf of Shell Energy Services Company concerning "stranded" costs and competitive market rates.

Expert witness in Case Nos. 99-1729-EL-ETP & 99-1730-EL-ETP, American Electric Power electric restructuring proceeding; testimony filed on behalf of Shell Energy Services Company. concerning stranded costs and competitive market rates.

Expert witness in Case No. 76-26-TP-CCS, Ohio Bell Telephone Company; testimony concerning service and equipment costs, tariff structures and competition in the telecommunications industry.

Expert witness in Case No. 78-676-EL-AIR, Ohio Power Company; testimony concerning rate of return and capital structure issues.

Expert witness in Case No. 79-1184-TP-AIR, Ohio Bell Telephone Company; testimony concerning proper ratemaking treatment of costs and adjustments for demand curtailment and stimulation.

Expert witness in Case Nos. 80-260-EL-AIR, and 80-429-EL-ATA, Cincinnati Gas & Electric Company; testimony concerning rate structure design, calculation of tariffs and revenue responsibilities.

Expert witness in Case No. 81-782-EL-AIR, Ohio Power & Light Company; testimony on company's request for rate increase.

Expert witness in Case No. 80-1155-GA-AIR et al., Columbia Gas of Ohio; testimony dealing with rate of return.

Expert witness in Docket No. 83-464-TP-COI, Ohio Bell Telephone Company; testimony concerning intrastate access charges.

Before the Oklahoma Corporation Commission -

Expert witness in Case No. 28002, Southwestern Bell Telephone Company; testimony concerning financial condition, cost of capital, rate of return and cost of service issues.

Expert witness in Cause No. 28123, Oklahoma Gas and Electric Company; testimony concerning rate of return, CWIP, and cash working capital issues.

Expert witness in Cause Nos. 28331 and 28875. Public Service Company of Oklahoma; testimony analyzing request for rate relief; presents a cost of capital study and addresses the allocations and determination of Transok's cost of service.

Expert witness in Cause No. 28309, testimony addressing the development of intrastate access charges.

Expert witness in Cause No. 29321, Southwestern Bell Telephone Company; testimony analyzing Southwestern Bell's request for interim intrastate rate relief; pursuant to intrastate rates, charges, services and practices necessary to achieve an increase in rate of return; and, intrastate access charges and tariffs.

Before the Oklahoma State Board of Property and Casualty Rates -

Expert testimony pertains to the earnings rate and the underwriting return allowed in establishing worker's compensation insurance rates.

Expert witness File No. 92-1566C; testimony concerning appropriate rate of return on the underwriting profit and contingency factor that should be allowed in establishing workers compensation insurance rates.

Before the Ontario Energy Board -

Expert witness in Case No. OEB-HR-17; Ontario Hydro; testimony concerning cost allocation and rate design issues and nuclear decommissioning cost matters and parallel generation.

Expert witness in Case No. E.B.R.O. 410-III and E.B.R.O. 414-II, The Consumers Gas Company, Ltd.; testimony concerning gas utility cost allocation and rate design.

Before the Ontario Legislative Assembly -

Ontario Hydro Select Committee; expert testimony on economic principles of electric utility rate structure design; March 9, 1976.

Before the Pennsylvania Insurance Commissioner -

Expert testimony concerning rate of return issues in determining private passenger automobile insurance rates.

Expert witness regarding rate of return in determining private passenger automobile insurance rates.

Expert witness to present testimony on the rate of return that should be allowed in establishing workers compensation insurance rates in Pennsylvania.

Expert witness to present testimony on the appropriate rate of return and on the underwriting profit and contingency factor that should be allowed in establishing workers compensation insurance rates that are not inadequate, excessive or unreasonably discriminatory, November, 1991.

Before the Pennsylvania Insurance Department -

Expert advice and analysis regarding the effect of market structure on Pennsylvania Blues' surplus position, November 2003.

Before the Pennsylvania Public Utility Commission -

Expert witness in Docket No. I-8400381, Philadelphia Electric Company; testimony pertains to Company's load forecast and the question of instituting regulatory incentives designed to improve performance and reduce electric utility costs.

Expert witness in Docket No. R-842651, Pennsylvania Power & Light Company; testimony concerning the impact of electric power rate increases on the local economy, the terms and conditions for the measurement of billing demands, the feasibility of deferred return ratemaking.

Expert witness in Docket No. 850152, Philadelphia Electric Company; testimony to assess the merits of adopting operating performance standards for PECO's nuclear power plants.

Expert witness in the Commission's 1984 Generic proceeding on the establishment of new cogeneration rates.

Expert witness in Docket No. A-2010-2176733, Joint Application For Approval Under Chapter 11 of the Pennsylvania Public Utility Code of the Change of Control of Qwest Communications Company, LLC and For All Other Approvals Required Under the Public Utility Code. Testimony in regard to issues pertaining to the proposed merger of CenturyLink and Qwest. July 2010.

Expert witness in Docket No. A-2010-2176520/A-2010-2176732, Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirsEnergy Corp, Testimony concerning the effect of the merger on competition. August 2010

Before the Rhode Island Public Utilities Commission -

Expert witness for the Commission Staff in Docket No. 1170, New England Telephone and Telegraph Company; testimony concerning rate of return, working capital allowance, tax issues and earnings erosion.

Expert witness for the Commission Staff in Docket No. 1167, Bristol County Water Company; testimony dealing with rate of return and the financial implications of leveraged capitalization within a multi-tier holding company structure.

Expert witness for the Commission Staff in Docket No. 1185, Blackstone Valley Electric Company; testimony concerning the principles of electric utility rate structure design.

Expert witness for the Commission Staff in Docket No. 1189, Providence Gas Company; testimony concerning rate of return for a gas utility.

Expert witness for the Division of Public Utilities and Carriers in Docket No. 1268, Newport Electric Corporation; testimony concerning rate of return.

Expert witness for the Division of Public Utilities and Carriers in Docket No. 1251, New England Telephone & Telegraph Company; testimony concerning rate of return.

Expert witness for the Division of Public Utilities and Carriers in Docket No. 1256, Wakefield Water Company; testimony regarding rate of return.

Expert witness for the Division of Public Utilities and Carriers in Docket No. 1258, Providence Gas Company; testimony regarding rate of return and cost of service.

Expert witness in Docket No. 1262, Blackstone Valley Electric Company; testimony presenting and summarizing the results of the Rhode Island Demonstration Project. Expert witness for the Division of Public Utilities and Carriers in Docket No. 1311, Newport Electric Corporation; testimony concerning inverted rates and lifeline rates.

Expert witness in Docket No. 1468, Narragansett Electric Company; testimony consists of a critique of the rate of return testimony presented by the Applicants' witness, and of an analysis of the cost of senior securities and common equity capital.

Expert financial and cost of service witness in Docket No. 1502, Bristol County Water Company; testimony concerning proposed rate increase.

Expert witness in Docket No. 1560, New England Telephone & Telegraph Company; testimony concerning rate of return, affiliated relationships, license contract, migration and related issues.

Expert witness in Docket No. 2320; Rhode Island Department of the Attorney General; testimony addressing various economic issues relating to electric utility restructuring. (A Plan for Restructuring the Electric Utility Industry was also prepared for the Rhode Island Department of the Attorney General.)

Before the Rhode Island Department of Business Regulation, Insurance Division -

Expert witness, National Council on Compensation Insurance, testimony concerning the appropriate rate of return and underwriting profit and contingency factor that should be allowed in establishing workers compensation insurance rates.

Before the South Carolina Department of Insurance -

Expert witness in Docket No. 82-053, Insurance Company of North America; testimony concerning the underwriting return for private passenger automobile insurance rates.

Expert witness in Docket No. 83-001, Rate Filing for Private Passenger Automobile Liability and Physical Damage Insurance Rate; testimony concerning rate level requirements for private passenger automobile insurance.

Expert witness in Docket No. 84-046, State Farm Mutual Automobile Insurance Company; testimony addresses the underwriting return that should be allowed in establishing private passenger automobile insurance rates (1984).

Expert witness, State Farm Mutual Automobile Insurance Company; testimony concerning the earnings rate and the underwriting return that should be allowed in establishing private passenger automobile insurance rates (1985).

Expert witness in Docket No. 84-023 concerning rates to be charged by South Carolina for fire insurance on dwellings.

Expert witness in 1987 workers compensation insurance rate case; testimony concerning earnings rate and underwriting return for establishing workers' compensation insurance rates in South Carolina.

Expert witness in 1988 Mark Four insurance rate case, Blue Cross and Blue Shield of South Carolina; testimony concerning earnings rate and underwriting return for establishing Mark Four insurance rates for Blue Cross in South Carolina.

Expert witness in 1989 workers' compensation insurance rate case; testimony concerning earnings rate and underwriting return for establishing workers' compensation insurance rates in South Carolina.

Before the South Carolina Public Service Commission -

Expert witness in Docket No. 80-69-E, Carolina Power & Light Company; testimony concerning rate design issues and the economic implications of electric utility rates and focusing on the PURPA cost of service standard.



Expert witness in Docket No. 82-328-E, Carolina Power & Light Company; testimony concerning rate of return issues.

Expert witness in Docket Nos. 84-388-E and 84-389-EIG, South Carolina Electric & Gas Company; testimony reviews the application pertaining to the restructure of SCE&G's corporate organization.

Before the South Dakota Public Utilities Commission -

Expert witness for the Commission Staff in Docket No. F-3112, Black Hills Power & Light Company; testimony dealing with rate of return, rate structure design, and subsidiary operations.

Expert witness for the Commission Staff in Docket No. F-3053, Montana-Dakota Utilities Company; testimony dealing with rate of return, rate structure design, and subsidiary operations.

Expert witness for the Commission Staff in Docket No. F-3054, Northern States Power Company; testimony concerning rate of return.

Expert witness for the Commission Staff in Docket No. F-3055, Northwestern Public Service Company; testimony concerning rate of return.

Expert witness for the Commission staff in Docket No. F-3052, Otter Tail Power Company; testimony concerning rate of return.

Expert witness for the Commission Staff in Docket No. F-3126, Montana Dakota Utilities Company; testimony dealing with electric utility rate of return.

Expert witness for the Commission Staff in Docket No. F-3159, Montana-Dakota Utilities Company; testimony dealing with gas utility rate of return.

Expert witness for the Commission Staff in Docket No. F-3153, Northwestern Public Service Company; testimony concerning rate of return.

Expert witness for the Commission Staff in Docket No. F-3164, Otter Tail Power Company; testimony concerning rate of return.

Expert witness for the Commission Staff in Docket No. F-3174, Black Hills Power & Light Company; testimony concerning rate of return issues.

Expert witness for the Commission Staff in Docket No. F-3188, Northern States Power Company; testimony concerning rate of return.

Expert witness in Dockets F-3240 and F-3241, Montana-Dakota Utilities Company; testimony concerning rate of return, cost of capital, rate structure design and coal subsidiary profits.

Expert witness in Docket No. F-3262, Black Hills Power & Light Company; testimony concerning rate of return, cost of capital, rate structure design and coal subsidiary profits.

Expert witness in Docket No. F-3367, Northwestern Public Service Company; testimony concerning rate of return and other ratemaking issues.

Expert witness in Docket No. F-3371, Nebraska Public Power District; testimony on proposed MANDAN Nominal 560KV Transmission Facility.

Expert witness in Docket No. F-3370, Montana-Dakota Utilities Company; testimony dealing with rate design.

Expert witness in Docket No. F-3382, Northern States Power Company; testimony on rate of return.

Expert witness in Docket No. F-3384, Montana-Dakota, Utilities Company; testimony on rate of return.

Expert witness in Docket No. F-3389, Black Hills Power & Light Company; testimony on rate of return and cost of service.

Expert witness in Docket No. F-3508, Northwestern Public Service Company; testimony examined electric rate requirements giving particular attention to cost of capital and rate of return.

Expert witness in Docket No. F-3391, Northwestern Public Service Company; testimony presents a cost of capital study and recommends a fair rate of return.

Before the Tennessee Public Service Commission -

Expert witness in Docket No. U-6285, South Central Bell Telephone Company; testimony pertaining to Western Electric's cost allocations and anticompetitive implications of South Central Bell's rate levels and rate design for telephone services.

Before the Texas Public Utility Commission -

Expert witness in Docket No. 78, Southwestern Bell Telephone Company; testimony concerning telephone equipment, telephone service costs, rate of design, and the economic implications thereof.

Expert witness in Docket No. 3094, General Telephone Company of the Southwest; testimony concerning the application for an adjustment in rates for intrastate telephone service.

Expert witness in Docket 2672, Southwestern Bell Telephone Company; testimony concerning telephone answering service rates proposed by Southwestern Bell.

Expert witness in Docket No. 5640, Texas Utilities Electric Company; testimony pertaining to rate of return and the inclusion of CWIP in rate base.

Expert witness in Docket No. 9300, Texas Utilities Electric Company; testimony concerning cost of capital, rate of return, revenue requirement, and "pure prudent investment rule" issues.

Expert Witness in Docket Nos. PUC 14980 and SOAH 473-95-1708, Office of Public Utility Counsel; testimony addressing various competitive market issues.

Expert witness in PUC Docket No. 15560, SOAH Docket 493-96-0897, Application of Texas-New Mexico Power Company for Approval of its Community Choice Transition Plan; testimony on behalf of the Texas Office of Public Utility Counsel concerning economic issues relating to TNP's application for approval of its "Community Choice Transition Plan", November, 1996.

Report to the Office of Public Utility Counsel on the Criteria for the Sale of Generation Assets by ERCOT Generation-Ownning Utilities; Criteria for Electric Generation Divestiture in ERCOT, October, 1998.

Expert witness in PUC Docket No. 25395, SOAH Docket No. 473-02-3457, Application of Central Power and Light for a Declaratory Order; testimony on behalf of Citgo Refining and Chemicals, L.P., responding to issues specified in the Commission's Preliminary Order of March 27, 2003, May 30, 2003.

**Before the Texas Railroad Commission -**

Expert witness for the City of San Antonio in Docket No. GUD-500, Lo-Vaca Gas Gathering Company; analysis of the economic impact upon purchased gas costs of certain extraordinary transactions.

**Before the Texas Railroad Commission -Gas Services Division**

Expert witness in Gas Utilities Docket No. 8664; Aligned Cities; testimony examining rate issues and related economic matters with an emphasis on corporate reorganization.

**Before the Texas State Board of Insurance -**

Expert witness in the Matter of Workers Compensation and Employer Liability Insurance Rates 1986; testimony concerning loss development, expense trending, investment income and other matters pertaining to the establishment of appropriate rate levels for workers compensation insurance in Texas.

Expert witness in the Matter of Private Passenger Automobile Insurance Rates (1986); affidavit concerning the appropriate underwriting margin for automobile liability and physical damage insurance rates in Texas.

Expert witness in Docket Nos. 1675 and 1678 concerning workers compensation insurance rates in the State of Texas; 1989.

Before the Public Service Commission of Utah -

Expert witness in Case No. 76-049-01, Mountain States Telephone & Telegraph Company; testimony concerning service and equipment costs, tariff structures and competition in the telecommunications industry.

Expert witness in Case No. 82-049-08, Mountain States Telephone & Telegraph Company; testimony concerning cost of service allocations between service categories and rate of return requirements and capital structure.

Expert witness in Case No. 83-049-05, Mountain States Telephone & Telegraph Company; testimony concerning the need for interim rate relief.

Expert witness in Case No. 84-049-01, Mountain States Telephone & Telegraph Company; testimony concerning post-divestiture cost estimates.

Expert witness in Case No. 84-035-02, Utah Power & Light Company; testimony addresses UP&L's application to form a wholly-owned subsidiary to carry out unregulated business enterprises.

Before the Vermont Public Service Board -

Expert witness in Docket 4299, Central Vermont Power Company; testimony concerning condemnation value and antitrust issues pertaining to the establishment of a municipal electric system in Springfield, Vermont.

Before the Virginia Corporation Commission -

Expert witness in PUE Case No. 790012; testimony concerning rate structure design, analysis of cost structure, revenue responsibilities, time-of-use rates, and customer responses.

Expert witness in Case No. PUE860031, Commonwealth Gas Services, Inc.; testimony concerning cost allocation, revenue requirements and rate design for Commonwealth Gas.

Expert witness in Case No. Ins. 860156; testimony concerning the appropriate underwriting margin for workers compensation insurers in the State of Virginia.

Expert witness in Case No. INS 870235; testimony concerning earnings rate and underwriting return for establishing workers' compensation rates in Virginia.

Expert testimony in Case No. INS 880340; testimony concerning earnings rate and underwriting return for establishing workers' compensation insurance rates in Virginia.

Expert witness in Case No. INS 890253, The Virginia Insurance Reciprocal; testimony concerning required return, profit and contingency factor, expense level, loss ratio and resulting change that should be implemented in establishing rates for lawyers professional liability insurance in Virginia; 1989.

Report on behalf of the Virginia Trial Lawyers Association, in Case No. INS870060, concerning whether lawyers' professional liability insurance is available in Virginia at reasonable prices and whether competition is an adequate regulator of rates; 1987.

Expert witness in Case No. PUE880053, Northern Virginia Gas; testimony concerning rate for interruptible transportation service proposed by NVNG; 1988.

Expert witness on behalf of the Attorney General in Case No. INS890313, St. Paul Fire & Marine Insurance Company and St. Paul Mercury Insurance Company; testimony concerning required return, profit and contingency factor, expense level, loss ratio and resulting change for establishing St. Paul's rates for physicians and surgeons medical malpractice liability insurance in Virginia; 1989.

Expert witness on behalf of the Attorney General in Case No. INS890416; concerning the identification of "troubled lines" of property/casualty insurance in the State of Virginia; 1989.

Expert witness on behalf of the Attorney General in Case No. INS 900256; concerning the determination of competition as an effective regulator of rates.

Expert witness on behalf of the Attorney General in Case No. INS 910224; testimony concerning rate of return that should be allowed in establishing workers compensation rates.

Expert witness on behalf of the Attorney General in Case No. INS 920241; testimony concerning competition as an effective regulator of rates pursuant to Virginia Code 38.2-1905.1.E.

Before the Virginia District Court (Eastern District) -

Expert witness of Civil Action No. 90-488-A, The Progressive Corporation v. Integon P & C Corporation; testimony concerning issues of competition and profitability in non-standard automobile insurance lines in Virginia.

The Virginia Trial Lawyers Association -

Report to the Virginia Trial Lawyers Association, *Report on Medical Malpractice Insurance in the Commonwealth of Virginia*, July 2003.

Prepared for the Virgin Islands Director of Banking and Insurance -

A Life and Health Insurance Examination and a Property and Casualty Examination for prospective insurance agents, along with a Training Manual for Insurance Agents, Brokers and Adjusters. (October, 1991)

Before the Washington State Utilities and Transportation Commission -

Expert witness in Case No. U-79-66, Pacific Northwest Bell Telephone Company; testimony concerning rate of return, cost of capital, and rate design.

Expert witness in Case No. U-82-19, Pacific Northwest Bell Telephone Company; testimony concerning rate of return and cost allocation issues.

Expert witness in Docket No. TO-011472, Olympic Pipe Line Company; testimony concerning cost of capital and rate of return, May 2002.

Expert witness for the Commission Staff in Docket Nos. UG-040640 and UE-040641 (consolidated) Puget Sound Energy, Inc.; testimony regarding cost of capital and rate of return, September 2004.

Before the Superior Court of Washington for Clark County -

Affidavit in No. 91 2 01840 9 in response to Plaintiff's Motion for Partial Summary Judgment concerning methods used to value utility property.

Before the West Virginia Public Service Commission -

Expert witness in PSC Case Nos. 8500, 8750, and 8879; Chesapeake & Potomac Telephone Company of West Virginia; testimony concerning service and equipment costs, tariff structures and competition in the telecommunications industry.

Before the West Virginia Insurance Commissioner -

Expert witness in the matter of Medical Malpractice Insurance Rates in the State of West Virginia, September, 1986; testimony concerning the appropriate underwriting margin and need for rate increases for medical malpractice underwriters.

Before the Public Service Commission of Wisconsin -

Expert witness in File Number 6720-TR-10, Wisconsin Telephone Company; testimony concerning service and equipment costs, tariff structure and competition in the telecommunications industry.

Expert witness in I-AC-15, WPSC Internal Wiring Proceeding; testimony concerning pricing standards for the sale of inside wiring.

Expert witness in Docket No. 6720-TR-34B, Wisconsin Telephone Company; testimony concerning Optional Local Measured Service.

Expert witness in Docket No. 6630-UR-100, Wisconsin Electric Power Company; testimony concerning the capital structure and fair rate of return for Wisconsin Electric Power.

Expert witness in Docket No. 6680-UM-100, merger of WPL Holdings, Inc. and Wisconsin Power & Light Company and all related transactions; testimony filed on behalf of The Wisconsin Intervenors relating to market power and merger induced efficiencies, evergreen contracts and merger remedies, May 1997.





**Verified Statement of Robert E. Verrecchia**  
**Finance Docket No. 35506**  
**Western Coal Traffic League — Petition for Declaratory Order**

October 28, 2011

## **Verified Statement of Robert E. Verrecchia**

I am Dr. Robert E. Verrecchia. I currently hold the title Elizabeth F. Putzel Professor of Accounting at the Wharton School of the University of Pennsylvania. I have over 35 years of experience teaching, advising and publishing on complex accounting issues. Indeed, for more than three decades, and more than a quarter-century at Wharton alone, I have taught an advanced accounting course that I currently title “Accounting for Mergers, Acquisitions, and Complex Financial Structures.” This course covers the accounting for business combinations. I first offered this course at the University of Chicago’s Graduate School of Business (now the Booth School of Business) in 1979. In addition to having taught this course at Wharton and Chicago, in 1997 I was invited to teach it at the University of Frankfurt in Frankfurt, Germany (Johann Wolfgang Goethe-Universität Frankfurt am Main) and in 2004 at Stanford University’s Graduate School of Business.

I hold a Ph.D. in accounting from Stanford University’s Graduate School of Business; an M.S. from The University of North Carolina at Chapel Hill; and a Sc.B. from Brown University. I taught accounting at the University of Illinois at Urbana-Champaign, the University of Chicago, and presently at the Wharton School of the University of Pennsylvania. In addition, I served as Chair of the Accounting Department at the Wharton School from 1985-1997.

In recognition of my scholarly contributions to the accounting literature, more than 50 published articles to date, I currently hold appointments to the editorial boards of numerous academic accounting journals, including: *Journal of Accounting and Economics*, *Journal of Accounting Research*, *European Accounting Review*, *Japanese Accounting Review*, and *Review of Quantitative Finance and Accounting*. My curriculum vitae is included as Attachment No. 1.

The purpose of my Verified Statement is to address the question of the applicability of the Generally Accepted Accounting Principles (GAAP) to the Surface Transportation Board's (STB) ratemaking function in the context of the purchase of BNSF Railway Company (BNSF) by Berkshire Hathaway Inc. (Berkshire) in 2010. In addition, I address the relevant GAAP principles that apply to mergers and business combinations for purposes of financial reporting. A summary of my Statement is as follows:

- GAAP governs the financial reporting responsibilities of regulated and unregulated businesses. Acquisition accounting is a technique for reconciling the purchasing entity's investment cost with the acquired company's net fair value, and thereby ensuring that the purchasing entity's balance sheet will continue to "balance" after a transaction has been consummated. Regulators, and not accountants or accounting rules, are responsible for establishing protections against unreasonable rates for jurisdictional businesses.
- Under GAAP, all business combinations initiated after December 15, 2008, are accounted for using the acquisition method, with all identifiable assets acquired or liabilities assumed of the acquired company recorded at their fair values at the acquisition date. If the cost of the business combination exceeds the acquired company's identifiable assets at fair value net of the liabilities assumed at fair value, one assigns the excess to goodwill.
- Regardless of how assets are recorded in financial statements under GAAP, GAAP does not speak to or govern rate regulation of affected businesses, GAAP does not require that regulators follow any accounting convention in establishing reasonable rates, or seek to usurp regulators' independent rate reasonableness responsibilities.
- The fact that the acquired company's identifiable assets and liabilities are assigned fair values (and goodwill is recorded) under GAAP acquisition accounting does not change the economic substance of the acquired company's assets or liabilities. GAAP techniques used to "balance" and reconcile accounts do not change the fact that the assets remain the same pre- and post-acquisition. The mechanical application of such techniques in ratemaking proceedings may produce unintended and skewed regulatory results.

## **GAAP Rules/Rate Reasonableness Rules**

GAAP consists of a collection of accounting rules and standards for financial reporting by all regulated and unregulated companies. The intent and purpose of GAAP, generally, is to ensure consistency in accounting practices; the accurate, full, and timely reporting of financial data; reporting continuity; and fairness to companies, investors, creditors, and the public who rely on statements to make sound decisions and determine a company's financial health. While GAAP standards are fairly extensive, GAAP's exclusive purpose is to establish accounting rules and standards for *financial reporting* by companies. Neither GAAP, nor the Financial Accounting Standards Board (FASB), which establishes the standards of financial accounting and reporting for nongovernmental entities, are designed to or are charged with addressing the ratemaking function of regulators. For example, GAAP [1] explicitly states:

*Other parties, such as regulators and members of the public other than investors, lenders, and other creditors, also may find general purpose financial reports useful. However, those reports are not primarily directed to these other groups.*

Regulators with jurisdiction over certain companies and rates and services, and not accountants or accounting rules, are responsible for establishing protections against unreasonable rates for all jurisdictional activities.

## **Accounting for Business Combinations**

Accounting for business combinations has long been subject to considerable debate and fraught with controversy. One reason for the debate and controversy is that the amounts involved when one firm acquires another firm are potentially of enormous magnitude. Accounting for amounts of enormous magnitude on a purchasing entity's financial statements that arise from the entity acquiring another company may have a substantive impact on how analysts, creditors, and investors perceive the purchasing entity's future performance.

Historically, much of the controversy concerning accounting requirements for business combinations focused on the fact that GAAP recognized two methods to account for a business combination, the pooling of interests method and the purchase accounting method. GAAP eliminated the pooling of interests method of accounting for all transactions initiated after June 30, 2001; this left the purchase method as the sole approach to consummating a business combination. More recently, GAAP [2] required that all business combinations initiated after December 15, 2008, be accounted for using the acquisition method. The acquisition method follows the same GAAP for recording a business combination as one follows for recording the purchase of other assets and the incurrence of liabilities. In effect, the acquisition method requires that one measure the cost to the purchasing entity (e.g., Buyer) of acquiring the common stock (shareholders' equity) of another company (e.g., Target) in a business combination by (1)

the amount of cash the Buyer disburses plus (2) the fair value of other assets the Buyer distributes plus (3) the fair value of any securities the Buyer issues. This (total) cost is commonly referred to as the Buyer's "investment cost" associated with acquiring the Target's equity.

A central feature of the acquisition method is that all identifiable assets acquired, liabilities assumed, or noncontrolling interest of the acquired company be recorded at their fair values at the acquisition date. Companies generally retain independent appraisers and valuation experts to determine fair values, although GAAP [3] does provide some guidance. After assigning fair values to all identifiable assets acquired and liabilities assumed, one compares the investment cost with the identifiable assets at fair value net of the liabilities assumed at fair value (i.e., net fair value). If the investment cost exceeds the net fair value of the acquired company – which is commonly the case – one assigns the excess to an account that is referred to as "goodwill."

### **The Role of GAAP Accounting in Regulatory Ratemaking**

As stated above, actions by all companies, both regulated and unregulated, involved in business combinations to write-up (or write-down) acquired assets to "fair value" is consistent with acquisition accounting principles. However, it is important to stress that the obligation of companies involved in a business combination to *report* their assets at fair value under the acquisition method of accounting is just that – *a financial reporting obligation*.

I understand that this presents a significant regulatory issue here with BNSF, with WCTL estimating that there is a substantial net acquisition premium of \$8,100,000,000 that BNSF is attempting to exclude from the rate base. I understand that, because of this very large premium, and because the "fair value" of BNSF's assets as recorded in the STB's Uniform System of Accounts feeds directly into the agency's Uniform Rail Costing System used for ratemaking purposes, there is the potential for substantial and adverse ratepayer impacts. Additionally, I understand that with higher valued assets on BNSF's books, BNSF will appear to be less financially secure and further from "revenue adequacy" under the STB's annual revenue adequacy determination.

Regardless of how assets are recorded in financial statements under GAAP, GAAP does not require that regulators follow any accounting convention in establishing reasonable rates. GAAP and FASB do not govern or control ratemaking or other similar regulatory responsibilities. These responsibilities remain *exclusively* under the province of the regulator (here, the STB) and are not usurped by any GAAP financial reporting requirements. Regulators are not constrained under GAAP from making appropriate regulatory adjustments for regulatory ratemaking or revenue adequacy purposes.

## Acquisition Accounting is Designed as a Technique for Purchasers to “Balance” Financial Statements; It is Not Designed for Ratemaking Purposes

The acquisition method does not change the underlying economic features of the acquired company's identifiable assets or liabilities. Rather, it is a technique for reconciling the purchasing entity's investment cost with the acquired company's net fair value, and thereby ensuring that the purchasing entity's balance statement will continue to “balance” after a transaction has been consummated. For example, prior to a business combination the assets and liabilities of the soon-to-be acquired company are stated on the balance statement of the company at their carrying value, where in the case of assets, carrying value could be thought to be the original historical cost of the asset to the company net of any depreciation, amortization, or depletion. In conjunction with the acquisition, the fact that the acquired company's identifiable assets and liabilities are assigned fair values that may differ from the carrying values of the assets and liabilities (and goodwill is recorded) does not change the economic substance of the acquired company's assets or liabilities – it simply changes the amounts assigned to the assets and liabilities on the purchasing entity's balance statement to reflect, or reconcile with, the purchasing entity's investment cost.

To illustrate this, consider two otherwise identical firms, Company A and Company B, that compete in an unspecified industry. Although it is not central to this illustration, one could imagine that because the firms are identical, each firm earns an identical profit. The Balance Statements for Companies A and B as of December 31, 2010 consist of Assets whose carrying value is \$3, Liabilities whose carrying value is \$2, and Shareholders' Equity of \$1. We illustrate this below.

Comparison of Company A and Company B															
<table><tr><th colspan="2">Balance Statement for Company A As of December 31, 2010</th></tr><tr><td>Assets: \$3</td><td>Liabilities: \$2</td></tr><tr><td></td><td>Shareholders' Equity: \$1</td></tr></table>		Balance Statement for Company A As of December 31, 2010		Assets: \$3	Liabilities: \$2		Shareholders' Equity: \$1	<table><tr><th colspan="2">Balance Statement for Company B As of December 31, 2010</th></tr><tr><td>Assets: \$3</td><td>Liabilities: \$2</td></tr><tr><td></td><td>Shareholders' Equity: \$1</td></tr></table>		Balance Statement for Company B As of December 31, 2010		Assets: \$3	Liabilities: \$2		Shareholders' Equity: \$1
Balance Statement for Company A As of December 31, 2010															
Assets: \$3	Liabilities: \$2														
	Shareholders' Equity: \$1														
Balance Statement for Company B As of December 31, 2010															
Assets: \$3	Liabilities: \$2														
	Shareholders' Equity: \$1														

Now let us assume that some firm whom we refer to as the Parent agrees to purchase Company A's common stock (shareholders' equity) for \$7 in cash on December 31, 2010. Here, \$7 represents the Parent's investment cost associated with acquiring Company A. Let us also assume that the fair value of Company A's Assets is \$5, whereas the fair value of Company A's Liabilities equals their carrying value of \$2. Similarly, the *fair values* of Company B's Assets and Liabilities would also be \$5 and \$2, respectively, because by assumption Companies A and B are otherwise identical.

Under GAAP [2] and in conjunction with purchasing Company A's common stock for \$7, the Parent would record on its (Consolidated) Balance Statement Company A's Assets at their fair value of \$5, Company A's Liabilities at their fair value of \$2 (which equals their carrying value), and then recognize Goodwill of \$4 to reconcile the difference between the Parent's investment cost of \$7 and Company A's net fair value (i.e., Company A's Assets at fair value net of Company A's Liabilities at fair value). In other words,

$$\text{Goodwill} = \text{Investment cost} - \text{Net Fair Value}$$

$$= \text{Investment cost} - (\text{Assets at fair value} - \text{Liabilities at fair value}).$$

Next we provide the accounts of Company A as they appear on the Parent's Balance Statement subsequent to the Parent's acquisition of Company A, and compare them to the Balance Statement of Company B.

Comparison of Company A and Company B															
<table><tr><th colspan="2">(Partial*) Consolidated Balance Statement for Parent As of December 31, 2010</th></tr><tr><td>Assets associated with Company A: \$5</td><td>Liabilities associated with Company A: \$2</td></tr><tr><td>Goodwill that arises from the acquisition of Company A: \$4</td><td></td></tr></table>		(Partial*) Consolidated Balance Statement for Parent As of December 31, 2010		Assets associated with Company A: \$5	Liabilities associated with Company A: \$2	Goodwill that arises from the acquisition of Company A: \$4		<table><tr><th colspan="2">Balance Statement for Company B As of December 31, 2010</th></tr><tr><td>Assets: \$3</td><td>Liabilities: \$2</td></tr><tr><td></td><td>Shareholders' Equity: \$1</td></tr></table>		Balance Statement for Company B As of December 31, 2010		Assets: \$3	Liabilities: \$2		Shareholders' Equity: \$1
(Partial*) Consolidated Balance Statement for Parent As of December 31, 2010															
Assets associated with Company A: \$5	Liabilities associated with Company A: \$2														
Goodwill that arises from the acquisition of Company A: \$4															
Balance Statement for Company B As of December 31, 2010															
Assets: \$3	Liabilities: \$2														
	Shareholders' Equity: \$1														
<p>*Partial because it only includes the Parent's accounts that are associated with Company A</p>															

Note that as it relates to the Parent's acquisition of Company A's common stock, the Parent's Balance Statement "balances" because the \$5 of Assets associated with Company A, plus the \$4 of Goodwill that arises from the acquisition of Company A, minus the \$2 of Liabilities associated with Company A, equals the reduction of \$7 in the Parent's cash account for the cash used to acquire Company A's common stock.

Our original premise was that prior to the Parent's acquisition of Company A on December 31, 2010, Company A and Company B were otherwise identical. This implies that immediately subsequent to the Parent's acquisition of Company A on December 31, 2010, the Assets and Liabilities of Company A and Company B continue to be identical: the application of GAAP [2] to consummate the Parent's acquisition of Company A does not change this identity. Rather, the fact that the values assigned to Company A's Assets and Goodwill that arise from the acquisition of Company A on the Parent's Balance Statement are different from the carrying value of Company B's Assets is simply the result of the technique employed in GAAP [2] to reconcile the amount the Parent paid to acquire Company A's common stock. Subsequent to the Parent's acquisition of Company A's common stock, there has been no change in the economic substance of Company A or its Assets or its Liabilities. In principle, Company A is still identical to Company B (allowing for the fact that the Parent now owns Company A).

For example, suppose the Parent agrees to pay \$11 in cash to acquire Company A's common stock. When the Parent's investment cost increases to \$11, Goodwill on the Parent's Balance Statement increases to \$8. We illustrate the reconciliation below.

Comparison of Company A and Company B															
<table><tr><th colspan="2">(Partial*) Consolidated Balance Statement for Parent As of December 31, 2010</th></tr><tr><td>Assets associated with Company A: \$5</td><td>Liabilities associated with Company A: \$2</td></tr><tr><td>Goodwill that arises from the acquisition of Company A: \$8</td><td></td></tr></table>		(Partial*) Consolidated Balance Statement for Parent As of December 31, 2010		Assets associated with Company A: \$5	Liabilities associated with Company A: \$2	Goodwill that arises from the acquisition of Company A: \$8		<table><tr><th colspan="2">Balance Statement for Company B As of December 31, 2010</th></tr><tr><td>Assets: \$3</td><td>Liabilities: \$2</td></tr><tr><td></td><td>Shareholders' Equity: \$1</td></tr></table>		Balance Statement for Company B As of December 31, 2010		Assets: \$3	Liabilities: \$2		Shareholders' Equity: \$1
(Partial*) Consolidated Balance Statement for Parent As of December 31, 2010															
Assets associated with Company A: \$5	Liabilities associated with Company A: \$2														
Goodwill that arises from the acquisition of Company A: \$8															
Balance Statement for Company B As of December 31, 2010															
Assets: \$3	Liabilities: \$2														
	Shareholders' Equity: \$1														
<p>*Partial because it only includes the Parent's accounts that are associated with Company A</p>															



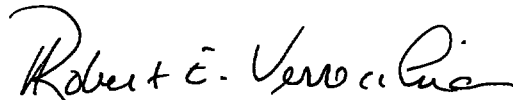
The salient point here is that the growth in Goodwill is simply a result of the fact that the Parent agrees to pay more for Company A's common stock, not a change in Company A or the underlying premise that Company A and Company B continue to be identical. Acquisition accounting is designed to balance and reconcile accounts, not to control ratemaking, or produce divergent regulatory results when applied to two identical companies. The mechanical employment of this accounting technique in a ratemaking proceeding may produce unintended and skewed regulatory results.

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- [3] FASB ASC 450. Originally, *Statement of Financial Accounting Standard No. 157*, "Fair Value Measurements." Norwalk, CT: Financial Accounting Standards Board, 2006.

## VERIFICATION

I, Robert E. Verrecchia, verify that I have read the foregoing Statement, know the contents thereof, and that the same are true as stated to the best of my knowledge, information and belief. Further, I certify that I am qualified and authorized to file this statement.

  
Robert E. Verrecchia

Executed on October 25, 2011

# Attachment 1

## Curriculum Vitae

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1970 Sc.B., Brown University

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1976-1979 Assistant Professor of Accountancy  
College of Commerce and Business Administration  
University of Illinois at Urbana-Champaign

#### Editorial appointments

*Journal of Accounting and Economics*, Associate Editor  
*Journal of Accounting Research*, Associate Editor  
*European Accounting Review*, Associate Editor  
*Review of Quantitative Finance and Accounting*, Associate Editor  
*The Japanese Accounting Review*, Advisory Editor

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"Management Forecast Bias," with Mirko Heinle, March, 2011

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"Disclosure and the Cost of Capital: Evidence of Information Complementarities," with Ian Gow and Dan Taylor, June, 2011.





**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**Western Coal Traffic League  
— Petition For Declaratory Order**

**Finance Docket No. 35506**

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Verified Statement

Of  
Thomas D. Crowley  
President

and

Daniel L. Fapp  
Vice President

L.E. Peabody & Associates, Inc.  
On Behalf Of  
Western Coal Traffic League

October 28, 2011

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**LIST OF EXHIBITS**

<b><u>EXHIBIT NO.</u></b>	<b><u>EXHIBIT DESCRIPTION</u></b>
(1)	(2)
1	Statement of Qualifications of Thomas D. Crowley
2	Statement of Qualifications of Daniel L. Fapp
3	Estimated Number of BNSF Shipments That Will Move Below The Jurisdictional Threshold
4	Summary Of Variable Cost and Jurisdictional Threshold Rates For Sample Movements
5	Development Of WFA/Basin Rates Per Ton Based on STB Procedures and BNSF 2010 URCS - - 4Q11

## **I. INTRODUCTION**

We are Thomas D. Crowley and Daniel L. Fapp. We are economists and, respectively, the President and a Vice President of L. E. Peabody & Associates, Inc., an economic consulting firm that specializes in solving economic, transportation, marketing, financial, accounting and fuel supply problems. Mr. Crowley has spent most of his consulting career of over forty (40) years evaluating fuel supply issues and railroad operations, including railroad costs, prices, financing, capacity and equipment planning issues. His assignments in these matters were commissioned by railroads, producers, shippers of different commodities, and government departments and agencies. A copy of his credentials is included as Exhibit No. 1 to this Verified Statement ("VS").

Mr. Fapp has been with L. E. Peabody & Associates, Inc. since 1997. During this time, he has worked on numerous projects dealing with railroad revenue, operational, economic and financial issues. Prior to joining L. E. Peabody & Associates, Inc., Mr. Fapp was employed by BHP Copper Inc. in the role of Transportation Manager - Finance and Administration, where he also served as an officer and Treasurer of the three BHP Copper Inc. subsidiary railroads. Mr. Fapp has also served as a guest lecturer in graduate level finance and economics classes at the University of Arizona discussing corporate capital theory and costs of equity determinations. A copy of his credentials is included as Exhibit No. 2 to this VS.

We have been requested by Counsel for the Western Coal Traffic League ("WCTL"), American Public Power Association, Edison Electric Institute, National Association of Regulatory Utility Commissioners, National Rural Electric Cooperative Association, Western Fuels Association, Inc., and Basin Electric Power Cooperative, Inc. ("Coal Shippers/NARUC") to address various aspects of Berkshire Hathaway Inc.'s ("Berkshire's") acquisition of the

Burlington Northern Santa Fe Corporation and its primary subsidiary, the BNSF Railway Company (collectively “BNSF”). Specifically, Counsel has requested that we comment on how Berkshire accounted for its acquisition of BNSF, including the allocation of the premium paid above BNSF’s net book value. Counsel also requested that we address how Berkshire’s acquisition accounting impacts the financial and reporting statements included in BNSF’s Annual Report Form R-1 submitted to the Surface Transportation Board (“STB”) and the subsequent impact on STB’s BNSF Uniform Railroad Costing System (“URCS”) variable costs. Finally, counsel requested that we discuss how the acquisition accounting methods will impact BNSF shippers, and, because of these impacts, why the STB should exclude the purchase premium Berkshire paid for BNSF from the STB’s regulatory determinations.

Our testimony is discussed further below under the following topical headings:

- II. Accounting For The BNSF Acquisition
- III. BNSF Acquisition’s Impact On URCS
- IV. BNSF Acquisition’s Impact On Shippers
- V. Exclusion Of The BNSF Acquisition Premium Is Proper

## **II. ACCOUNTING FOR THE BNSF ACQUISITION**

Berkshire acquired BNSF on February 12, 2010 pursuant to a November 2, 2009 merger agreement approved by both companies' board of directors. Immediately prior to the merger, Berkshire owned approximately 22.5 percent of the BNSF common equity issued and outstanding. The remaining shareholders received a mix of cash and Berkshire Class B common equity for their shares in BNSF. At the close of the acquisition, R Acquisition Corporation, an indirect wholly owned subsidiary of Berkshire, merged with BNSF to form Burlington Northern Santa Fe Railroad, L.L.C. The BNSF Railway Company subsequently became an indirect subsidiary of Berkshire.

Berkshire accounted for its BNSF acquisition using the Acquisition Accounting method ("Acquisition Accounting"). Under Acquisition Accounting, the acquiring company initially records the investment in the acquired company based on the amount of cash and the market value of other net assets given in the exchange. If the acquiring company pays more than the book value of the company being purchased, it must account for this premium over book on its subsequent financial statements.<sup>1</sup> This allocation of higher value generally happens by estimating the current fair market value of the acquired companies assets and liabilities. If the premium paid for the company is higher than the net fair value of the purchased company's assets, the remaining value is placed on the financial statements as goodwill. In other words, the purchasing company assesses the fair market value of the acquired company's assets and

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<sup>1</sup> The term "premium" can have several different definitions when discussing mergers and acquisitions. Equity analysts will use the term premium to describe the price per common equity share paid above the then prevailing market price before the purchase announcement. Accountants may describe the premium paid as the goodwill placed on the acquired company's balance sheet. Similarly, others may use the term to describe the value of the acquisition above the net book value of the company prior to the acquisition. We primarily use this final meaning of premium, the difference between net book value and acquisition value, in this VS. Given this definition, the premium can be thought of as consisting of two parts. The first part is the difference between the net book value of the assets and liabilities prior to the acquisition and the fair market value allocated after the purchase. The second part consists of the goodwill placed on the company's financial statements. Since goodwill does not impact many of the costs considered by the STB, our use of the term premium when discussing the STB and its costing means the premium paid above the net book value and the assessed fair market value of the assets.

liabilities, and compares the purchase price to the assessed fair market values. If the price paid for the company exceeds the net fair market value of assets and liabilities, the purchasing company places the acquired company's assets and liabilities on its books at the fair market value and any excess is recorded as goodwill on the purchased company's balance sheet.

In addition to establishing the net asset and liability values for the newly acquired company, SEC Staff Accounting Bulletin No. 54, Topic 5J ("SAB54") requires the purchaser to "push down" the value of the acquisition, including any premium paid, for those companies filing financial statements with the SEC if the acquiring company owns more than 90 percent of the common stock of the company being acquired. The SEC believes when the form of ownership is within the control of the parent company, as is when the acquiring company controls over 90 percent of the common stock, the basis of accounting should reflect the full cost of acquiring the new assets.

Consistent with SAB54, Berkshire pushed down its acquisition costs to BNSF's railroad company's financial statements. BNSF indicated in its Annual Report R-1 that the basis of accounting for BNSF's railroad company equaled \$42.9 billion.<sup>2</sup> Berkshire pushed down and allocated the \$42.9 billion to the railroad's tangible and intangible assets and liabilities at their respective fair market values, with the remainder allocated to goodwill as shown in Schedule 200, Note 1 of BNSF's 2010 Annual Report Form R-1. Using year-end data and the acquisition accounting adjustments included in BNSF's Annual Report Form R-1 and BNSF's acquisition accounting workpapers provided in this proceeding, we developed the estimated net impact of the acquisition on BNSF's property, plant and equipment assets ("PPE"), after consideration of

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<sup>2</sup> See BNSF 2010 Annual Report R-1, Schedule 200, Note 1. The new basis for accounting shown in the Annual Report Form R-1 is consistent with the new basis of accounting included in BNSF Railway's Form 10-Q for the quarterly period ending March 31, 2010 at page 9.



changes in asset values, depreciation and deferred taxes. As shown in our workpapers<sup>3</sup> supporting this VS. this push down resulted in a \$8.1 billion net increase in BNSF's PPE assets.<sup>4</sup>

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<sup>3</sup> See "Summary of URCS Adjustments to Eliminate 2010 premium. pdf" and "Impact of acquisition on BNSF URCS accounts. xls".

<sup>4</sup> We had originally estimated that the net impact on PPE and deferred taxes from Berkshire's acquisition equaled approximately \$7.6 billion, which Counsel included in its petition in this proceeding. We based this estimate originally on summary data contained in BNSF's 2010 Annual Report Form R-1, including data contained in Schedules 200, 245, 330, 335, 450 and other subsidiary schedules. For our estimate of the purchase impact on deferred tax credits, we used data shown in Schedule 450, which showed an accounting adjustment of \$5.0 billion for depreciation and amortization. Since the Annual Report Form R-1 contains only summary data and not detailed workpapers, it is not possible to effectively trace all changes through the various Annual Report Form R-1 schedules. After receiving BNSF's workpapers supporting its acquisition accounting adjustments, we found that the majority of our initial estimates were consistent with BNSF's adjustments. BNSF's workpapers showed, however, that they made additional adjustments to their deferred tax calculations that were not referenced in their Annual Report Form R-1 schedules. Based on this new data, we have revised our estimate of the net impact on PPE to approximately \$8.1 billion.

### **III. BNSF ACQUISITION IMPACT ON URCS**

As discussed above, Berkshire accounted for the BNSF acquisition using the Acquisition Accounting method, which pushed down \$42.9 billion to the railroad operating company's financial statements. More importantly for shippers, the accounting adjustments made by Berkshire and brought about by the acquisition increased BNSF's net investment base by \$8.1 billion and impacted BNSF's operating expenses by \$128 million. These factors have a direct impact on BNSF's URCS variable costs, which the STB uses for numerous regulatory actions including establishing prescribed maximum rate levels under the STB's ratemaking authority.

#### **A. BNSF PURCHASE PREMIUM IS INCLUDED IN BNSF'S ANNUAL REPORT**

Pursuant to 49 U.S.C 11145, each Class I railroad must submit on a yearly basis an Annual Report Form R-1 to the STB. The STB uses information in the Annual Report Form R-1 to monitor and assess railroad industry growth, financial stability, traffic and operations and to identify industry changes that may impact national transportation policy. In addition, the STB uses data contained in the Annual Report Form R-1 to regulate financial transactions, conduct investigations and rulemakings, develop rail cost adjustment factors and develop individual railroad URCS formulas.

BNSF submitted its 2010 Annual Report Form R-1 to the STB in April 2011. Schedule 200 of BNSF's 2010 Annual Report Form R-1 contains the railroad's Comparative Statement of Financial Position, or Balance Sheet, including explanatory notes to the schedule. Explanatory Note 1 contains a description of BNSF and its various subsidiaries, and provides a brief

description of Berkshire's acquisition of the BNSF.<sup>5</sup> Explanatory Note 1 also describes the accounting treatment under which Berkshire accounted for the BNSF acquisition, noting that under Acquisition Accounting, the new accounting basis for BNSF equaled \$42.9 billion, which Berkshire pushed down to the railroad's tangible and intangible assets and liabilities at their respective fair market values. This resulted in BNSF's PPE accounts increasing to \$45.76 billion, or a net increase of \$8.1 billion from prior year PPE net investment amounts, including deferred taxes. As BNSF succinctly indicates in Explanatory Note 1, "The above adjustments are included in the December 31, 2010 balances of various accounts and schedules in this annual R-1 report consistent with Code of Federal Regulation Title 49 requirements." In simple terms, BNSF has included its purchase adjustments and premiums in its Annual Report Form R-1 values.

**B. BNSF'S PURCHASE PREMIUM  
FLOWS THROUGH TO  
THE STB'S URCS**

URCS is the railroad general purpose costing system that the STB uses to estimate variable unit costs for Class I U.S. railroads.<sup>6</sup> The STB relies upon URCS for a variety of statutory and non-statutory functions, including calculating the 180 percent jurisdictional threshold determination in railroad maximum rate reasonableness proceedings. The STB also uses its URCS variable costs to establish prescribed rates under all of its maximum reasonable rate approaches.

URCS consists of three phases or steps. Phase I is the collection of data and special studies (Variability Study, Switching Study, etc). Phase II is the calculation of system average

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<sup>5</sup> See BNSF 2010 Annual Report Form R-1 at page 9.

<sup>6</sup> See <http://www.stb.dot.gov/stb/industry/urcs.html>.

variable unit costs based on system data and cost relationships developed in Phase I. Phase III is the Movement Costing Program which is used to estimate the system average variable costs of a shipment.

Each year, the STB updates Phase I of its URCS formulas with data provided by the railroads included in each railroad's Annual Report Form R-1, and subsequently recalculates its system average variable unit costs using the updated Phase I data. Because URCS separates the inputs into different tables, it is a straightforward exercise to update the URCS tables with new information.

Given the use of well documented tables to develop the URCS inputs, making adjustments to URCS is a relatively straightforward process. Attachment No. 3 to WCTL's May 2, 2011 Petition in this proceeding included the procedures to adjust the URCS inputs to eliminate the acquisition premium from the financial statements included in the BNSF 2010 Annual Report Form R-1 that are used to develop the URCS. As noted in WCTL's petition, the modifications to the URCS inputs are a straightforward exercise. However, at the time of the filing of WCTL's Petition, some of the specific accounts impacted by the acquisition premium could not be determined without further information from BNSF. After the STB's ruling on WCTL's petition, BNSF provided the workpapers supporting how the acquisition premium was accounted for in its 2010 Annual Report Form R-1.

Based on the updated information provided by BNSF supporting its accounting adjustments, we have updated Attachment No. 3 in WCTL's Petition to identify the changes to URCS needed to eliminate the acquisition premium. We have included these adjustments in our workpapers to this VS, which follow the same format as Attachment No. 3 to WCTL's Petition and updates the changes to reflect the data provided by BNSF in this proceeding.

Using the adjustments to the BNSF's financial statements shown in our workpapers to this VS, we have developed a BNSF 2010 URCS on three bases. First, we developed the BNSF 2010 URCS utilizing the data in BNSF's Annual Report Form R-1 and other inputs reported by BNSF ("BNSF 2010 Unadjusted URCS"). The unit costs developed in this BNSF 2010 URCS include the net acquisition premium paid above book value and included in BNSF's 2010 financial statements. Second, we modified the inputs to the BNSF 2010 URCS to reflect these changes ("BNSF 2010 URCS excluding acquisition premium"). Third, we modified the BNSF 2010 URCS excluding acquisition premium by including the impact of including BNSF in the STB's 2010 cost of capital determination. Each BNSF 2010 URCS formula has been included with our workpapers accompanying this VS.

The implications of the adjusted URCS are clear. Unless the STB orders otherwise, accounting adjustments that BNSF makes to its Annual Report Form R-1 data will directly flow into the STB's URCS model and impact the variable costs produced. Therefore, the adjustments BNSF made to account for the premium Berkshire paid above book value for BNSF will flow directly into BNSF's URCS variable costs. The accounting adjustments made pursuant to the Berkshire acquisition increased BNSF's net PPE accounts leading to higher return on investment ("ROI") costs in URCS. Similarly, the adjustments impact BNSF's depreciation expenses, which impact variable URCS operating expenses. These and other changes will occurred without a corresponding change in BNSF's operations. In other words, they were all accounting adjustments due solely to a change in ownership, and not to a change in BNSF's operations. The end result of these accounting changes from Berkshire's purchase of BNSF would be higher URCS variable costs compared to if the purchase had never occurred.

#### **IV. BNSF ACQUISITION'S IMPACT ON SHIPPERS**

If permitted, the inclusion of the premium above book value that Berkshire paid for BNSF in BNSF's Annual Report Form R-1, and subsequently BNSF's URCS variable costs, will unfairly impact BNSF shippers by increasing their rates. Unlike previous mergers and acquisitions within the railroad industry that involved the merger of two or more railroad operations, Berkshire made a pure financial play in acquiring BNSF, and had no plans to merge BNSF with any other railroad company or other Berkshire operating companies.<sup>7</sup> As such, and as indicated by BNSF management, no changes in operations occurred because of the acquisition by Berkshire. This means that BNSF gained no synergistic cost benefits to off-set the premium paid for BNSF, and that BNSF will pass through the full premium paid to its URCS costs.

Passing through the acquisition premium to the URCS variable costs will directly impact a large number of shippers. At the threshold, the increase in BNSF URCS variable costs will increase the 180 percent jurisdictional threshold for BNSF shippers, and decrease the number of shippers that may seek STB rate relief. Based on 2010 reported BNSF carload/intermodal unit data and data developed from STB reports, we estimate the number of carloads/intermodal units impacted by the shift in the jurisdictional threshold will be approximately 125,000 carloads per year.<sup>8</sup>

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<sup>7</sup> As part of the BNSF acquisition, Berkshire set up an indirect wholly owned subsidiary named R Acquisition Company, LLC, which was effectively a shell company created solely to facilitate the merger. As indicated in Berkshire's SEC Form S-4 at page 95, R Acquisition Company, LLC "...was formed solely for the purpose of facilitating the merger. Merger Sub (R Acquisition Company, LLC) has not carried on any activities or operations to date, except for those activities incidental to its formation and undertaken in connection with the transactions contemplated by the merger agreement."

<sup>8</sup> We have based this figure on the number of 2010 carloads/intermodal units BNSF shipped and the estimated amount of traffic with R/VC ratios between 180 and 300 percent as reported in a 2010 Report to the STB prepared by Lauritis R. Christensen Associates, Inc. This is a conservative estimate of the number of shippers impacted as we assume an even distribution of shipments within the 180-300 percent R/VC range. In actuality, the distribution is likely more normally distributed with a greater number of shippers with 180 percent R/VC ratios than 300 percent R/VC. Exhibit No. 3 demonstrates our estimate of the impacted traffic.

The inclusion of the premium will also increase rates for those shippers whose rates are set through the application of variable costs, which primarily are shippers with rates prescribed by the STB. However, the pass through of the purchase premium will also impact other shippers who entered into contracts with BNSF and whose rates were established by revenue to variable cost ("R/VC") ratios. In addition, the acquisition will impact shippers who use STB maximum rate standards in rate negotiations, and as the BNSF attempts to reach its stated goal of equalizing captive and competitive rates.

Finally, including the premium paid for BNSF in the railroad's Annual Report Form R-1 schedules and URCS variable costs will have longer term impacts on shippers as their 180% jurisdiction thresholds will increase with the increase in URCS variable costs.

**A. THE PURCHASE PREMIUM  
WILL NOT BE OFF-SET BY  
SYNERGISTIC COST REDUCTIONS**

Financial experts and economists consider Berkshire's acquisition of BNSF a classic example of a conglomerate merger, which was the principle type of merger seen in the 1960s and 1970s, and customarily involve companies in unrelated lines of business.<sup>9</sup> This type of merger differs from the two other typical types of mergers, vertical mergers and horizontal mergers. Vertical mergers involve companies at different stages of production, and seek to add value by moving forward or backwards along the supply or production chain. For example, an automobile manufacturer acquiring a steel company from which it purchases steel is a typical example of a vertical merger. Horizontal mergers on the other hand combine two companies involved in the same line of business. Most railroad mergers seen in the last few decades have been horizontal

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<sup>9</sup> See Brealey, R. A., Myers, S. C., and Allen, F., "Principles of Corporate Finance, Eighth Edition," McGraw-Hill Irwin, 2006. at page 871 ("Brealey, Myers and Allen").

mergers, including CSX Transportation (“CSXT”) and Norfolk Southern Railway’s (“NS”) purchase of Consolidated Rail Corporation (“Conrail”), Union Pacific Railway Company’s (“UP”) purchase of Southern Pacific Transportation Company (“SP”) and Burlington Northern Railroad Company’s (“BN”) merger with the Atchison Topeka and Santa Fe Railway Company (“ATSF”).

Companies acquire and merge with other firms for numerous financial and operational reasons. The largest operational reason for seeking a merger or acquisition is to seek synergies, or, in other words, possible sources of added value. These synergies can come through various forms including:

1. Economies of scale, scope and density;
2. Economies of vertical integration;
3. Combining complementary resources; and
4. Eliminating inefficiencies.

These synergies almost always occur in horizontal or vertical mergers. While it is not unheard of for conglomerate mergers to experience some synergies, especially where top levels of the merged companies’ management are reduced, conglomerate mergers seek to add value through exploiting financial or investment opportunities.

As we discuss below, the companies involved in the majority of recent Class I railroad mergers and acquisitions based their decisions on the availability of large synergies brought about by what are effectively horizontal mergers. In fact, the Interstate Commerce Commission (“ICC”) and STB based their approval of these transactions largely on the presumed synergies created by the mergers.

Unlike prior railroad mergers and acquisitions, Berkshire’s acquisition of BNSF has led to little or no appreciable synergies for BNSF. BNSF has not made any changes to its operations



since its acquisition by Berkshire, and has stated it does not plan to make any changes in the future. For example, BNSF President and Chief Executive Officer Matt Rose indicated in "Railway Magazine," an internal BNSF magazine, that "[w]hile this agreement [to be acquired by Berkshire] will result in a change of ownership, you won't notice many other changes."<sup>10</sup>

Mr. Rose went on to state in an interview with the Wall Street Transcript:

TWST: Has it [the Berkshire acquisition] changed your operations, and if so, how?

Mr. Rose: In terms of running the railroad, I would say no. The transition itself was unbelievably seamless. Often with acquisitions, you tend to think you'll have a lot of management turnover, and we had very, very little management turnover. We literally lost two people from our leadership team, and those were very logical positions to lose. One was our Head of Investor Relations and the second was our SEC attorney, our Corporate Secretary. The entire operational team stayed in place. Outside of no longer having a board of directors and no longer having a publicly traded company - although Berkshire Hathaway is public - the operation itself has not seen any difference whatsoever.<sup>11</sup>

BNSF coal marketing manager John Lanigan echoed Mr. Rose's statements that the Berkshire acquisition would lead to no operational changes in a letter to BNSF coal shippers.

In a November 3, 2009 letter to coal shippers, Mr. Larugan stated:

You will not see any changes in the weeks and months ahead. Our leadership will remain in place and focused on providing value to our customers. We will continue our efforts to provide you with the same outstanding service you have come to expect from BNSF. Your day-to-day contacts and the way we interact with you will not change. We will continue to work with other railroads as we always have to provide interline services. In other words, you

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<sup>10</sup> See "Railway Magazine" Special Edition available at <http://www.bnsf.com/employees/communications/railway-magazine/pdf/special.pdf>

<sup>11</sup> The Wall Street Transcript, February 22, 2011 available at <http://www.twst.com/yagoo/als609MATTHREW1.html>

should expect business as usual.<sup>12</sup>

Berkshire, and its CEO Warren E. Buffet, typically operate Berkshire subsidiaries as autonomous entities. As indicated in Berkshire's SEC Form S-4 filed as part of the BNSF acquisition, "Operating decisions for the various [Berkshire] operating businesses are made by managers in the business units." There is little, if any, cooperation between Berkshire's operating companies. This fact, along with BNSF's statement that it has not made any changes to its operations since its acquisitions, indicates that no material synergies were gained in the acquisition that would pass through to BNSF shippers.

The STB has considered operating synergies a key factor in approving prior railroad acquisitions and mergers. The STB stated in the *Conrail Acquisition*<sup>13</sup> that the presence of operating synergies would lead to stable URCS costs as the efficiencies gained by the acquisition would off-set the impact of the purchase premium.<sup>14</sup> However, as discussed in greater detail below, no such synergies exist in this business combination as both companies have indicated the purchase would lead to no changes in operations.

**B. THE PURCHASE PREMIUM  
WILL DIRECTLY IMPACT  
MANY BNSF SHIPPERS**

The increase in the BNSF's URCS variable costs brought about by the inclusion of the premium over book value that Berkshire paid for BNSF will directly impact certain shippers whose rates are prescribed by the STB. Additionally, the premium will impact other shippers as

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<sup>12</sup> Customer Letter from John Lanigan available at <http://domino.bnsf.com/website/updates.nsf/updates-customer-coal/155EA596E0A7BC40862576630056F30D?Open>

<sup>13</sup> Docket No. 33388, *CSX Corporation and CSX Transportation Inc., Norfolk Southern Corporation And Norfolk Southern Railway Company--Control and Operating Leases Agreements--Conrail Inc And Consolidated Rail Corporation*, 3 STB 196, ("Conrail Acquisition")

<sup>14</sup> See *Conrail Acquisition* at page 263.

it will limit the number of shippers that may seek STB relief due to increases in the 180 percent jurisdictional threshold and will allow for increases in BNSF's captive rail rates. Included as Exhibit No. 4 are two examples of the impact the acquisition premium will have on a movement's variable costs and resulting jurisdiction thresholds. The first example is a hypothetical unit coal train movement and the second example is a hypothetical unit grain train movement.

### **1. Impact On BNSF Shippers With Rate Prescriptions**

#### **a. Rates Prescribed Under The SAC Constraint**

Prior to its decision in *Major Issues*<sup>15</sup>, the STB prescribed rates under the stand-alone cost ("SAC") constraint on a dollar per unit basis.<sup>16</sup> In *Major Issues*, the STB changed this approach and ordered that future rate prescriptions be based on maximum R/VC ratios instead of specific rates per unit.<sup>17</sup> Providing prescribed R/VC ratios instead of prescribed rates per unit opens the STB's ratemaking authority to any action that influences a railroad's URCS variable costs. This has a direct impact on BNSF shippers as the premium above book value paid by Berkshire is effectively passed through to the shipper in the form of higher variable costs to which the prescribed R/VC ratio is applied. This will impact all BNSF shippers requesting relief from to the STB.

For example, WFA/Basin came to the STB seeking rate relief on BNSF shipments of coal from Powder River Basin to the Laramie River Generating Station. After several rounds of evidence, the STB determined BNSF had published unreasonable rates to the Laramie River

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<sup>15</sup> Ex Parte No. 657 (Sub-No. 1), *Major Issues in Rail Rate Cases*, served October 30, 2006 ("*Major Issues*")

<sup>16</sup> See *Major Issues* at page 9, and STB Docket No. 42057, *Public Service Company of Colorado D/B/A Xcel Energy vs. The Burlington Northern Santa Fe Railway Company*, 7STB 589 at 625 ("*Xcel*").

<sup>17</sup> See *Major Issues* at page 14.

Station, and prescribed R/VC ratios.<sup>18</sup> Following the STB's decision in *WFA/Basin*, WFA/Basin's rates for 2011 are based on the variable costs for the unit coal train movements from each origin multiplied by the STB 2.46 prescribed R/VC ratio. For 4Q11, the current rates are based on BNSF 2009 URCS unit costs applied to the traffic and operating factors for 3Q11.

Following the STB procedures, we calculated the variable costs for the WFA/Basin trains moving in 3Q11 based on the BNSF 2010 unadjusted URCS. We then developed the two alternative URCS variable cost calculations that considered the impact of the BNSF acquisition. The first alternative included the adjustment discussed above to remove the impact of the BNSF acquisition from the Annual Report Form R-1 inputs into URCS. The second alternative included the Annual Report Form R-1 input adjustments plus the impact on the STB 2010 railroad industry cost of capital assuming BNSF were still included in the cost of capital cohort.

We developed for WCTL an estimate of the 2010 railroad industry cost of equity assuming BNSF had remained in the railroad cost of capital cohort, and presented this estimate in our VS in *2010 Cost of Capital*<sup>19</sup>. We believe that including BNSF in the STB's cost of capital calculation makes sense from both financial and policy perspectives. Depending upon which metrics are used, the BNSF is either the first or second largest railroad in the U.S., and is therefore a key component of the U.S. railroad industry. Additionally, its removal from the composite group disrupts the balance between eastern and western railroads that has prevailed for a large number of years. The railroad companies themselves have repeatedly noted that east is not the west, and removing the BNSF from the group places much greater weight on the performance and risks faced by the eastern railroads. We contend that it is difficult to say that the Class I railroad industry cost of capital is being calculated properly when the one of the

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<sup>18</sup> See STB Docket No. 42088, *Western Fuels Association, Inc., and Basin Electric Power Cooperative v BNSF Railway Company*, served February 18, 2009 ("*WFA/Basin February 2009*") decision at pages 29 to 31.

<sup>19</sup> STB Ex Parte No. 558 (Sub-No. 14), *Railroad Cost of Capital – 2010*, submitted on June 2, 2011 ("*2010 Cost of Capital*")

largest players, or the largest player, is removed from the calculation. Finally, as demonstrated in our *2010 Cost of Capital VS*, exclusion of the BNSF from the STB's cost of capital calculations artificially increases the railroad industry cost of capital.<sup>20</sup>

To estimate the impact including the BNSF would have on the railroad industry 2010 cost of equity, we developed a simple analysis that included the weighted cost of Berkshire CAPM and MS-DCF costs of equity with the three railroad companies included in the composite group. To estimate the BNSF's market weights, we developed the ratio of BNSF's assets to total Berkshire assets, and applied this ratio to Berkshire's equity market cap. These estimated BNSF market caps were used with publicly reported Berkshire share price data and with the market cap and share prices for the three composite railroad companies to develop an industry beta, from which a CAPM cost of equity was developed. To estimate a MS-DCF cost of equity for the industry, we used the MS-DCF costs of equity for the three composite group railroads and the Berkshire MS-DCF cost of equity as calculated by Morningstar/Ibbotson, and weighted these on their actual or estimated year-end market caps. The result was to develop a CAPM cost of equity of 11.01 percent and MS-DCF cost of equity of 12.86 for an average cost of equity of 11.94 percent. Using this revised cost of equity, we developed an updated after-tax and pre-tax railroad industry costs of capital of 10.23 percent and 15.15 percent, respectively.<sup>21</sup>

Table 1 summarizes BNSF's variable costs based on the three BNSF 2010 URCS formulas<sup>22</sup> that we developed, i.e., based on BNSF as reported data, BNSF excluding the acquisition premium, and BNSF excluding the acquisition premium plus the impact on the STB's 2010 cost of capital determination of including BNSF.

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<sup>20</sup> See Crowley/Fapp *2010 Cost of Capital VS*.

<sup>21</sup> We have included our cost of capital estimates in our workpapers to this VS.

<sup>22</sup> The STB has not yet released its 2010 BNSF URCS formula. L. E. Peabody & Associates, Inc. developed the three 2010 BNSF URCS formulas used in this VS. Copies of these three 2010 BNSF URCS formulas are included in our workpapers accompanying this VS.

<b>Table 1</b> <b>Summary of BNSF Variable Costs For WFA/Basin Unit Trains – 3Q11</b>				
<b>BNSF Variable Cost /Ton Based on BNSF 2010 URCS</b>				
<b>Origin</b>	<b>3Q11</b>	<b>As Reported</b> 1/	<b>Excluding</b>	<b>Excluding</b>
<b>(1)</b>	<b>Tons</b>		<b>Acquisition</b>	<b>Acquisition Premium</b>
	<b>(2)</b>	<b>(3)</b>	<b>Premium</b> 2/	<b>Plus Impact</b>
			<b>(4)</b>	<b>On 2010 COC</b> 3/
				<b>(5)</b>
1. Antelope	447,194	\$1.97	\$1.87	\$1.85
2. Black Thunder	82,532	\$2.27	\$2.17	\$2.14
3. Buckskin	196,622	\$2.93	\$2.81	\$2.78
4. Caballo	244,002	\$2.59	\$2.48	\$2.44
5. Dry Fork	627,723	\$2.85	\$2.73	\$2.69
6. North Antelope	115,109	\$2.06	\$1.96	\$1.93
7. Thunder West	<u>16,541</u>	<u>\$2.35</u>	<u>\$2.24</u>	<u>\$2.21</u>
8. Total/Weighted Average	1,729,723	\$2.51	\$2.40	\$2.37

1/ Based on BNSF 2010 URCS with 3Q11 traffic and operating factors.  
2/ Based on BNSF 2010 URCS adjusted to exclude the acquisition premium with 3Q11 traffic and operating factors.  
3/ Based on BNSF 2010 URCS adjusted to exclude the acquisition premium plus the impact of including BNSF in the STB's 2010 cost of capital ("COC") determination with 3Q11 traffic and operating factors.

As shown in Table 1 above, WFA/Basin received 1.7 million tons of coal from seven origins in 3Q11. BNSF's 3Q11 weighted average variable costs based on BNSF's 2010 URCS formula (as reported) equal \$2.51 per ton (Table 1, Column (3), Line 8). When the BNSF 2010 URCS excluding the acquisition premium is utilized to calculate variable costs, BNSF's weighted average variable costs equal \$2.40 per ton (Table 1, Column (4), Line 8). Stated differently, the acquisition premium increased BNSF's 3Q11 variable costs by \$0.11 per ton (\$2.51 minus \$2.40). When the BNSF 2010 URCS is adjusted to not only exclude the acquisition premium but also to include the impact on the STB's 2010 cost of capital determination of including BNSF, BNSF's 3Q11 weighted average variable costs equal \$2.37 per ton (Table 1, Column (5), Line 8). Stated differently, the acquisition premium including the

impact on the STB's 2010 cost of capital increased BNSF's 3Q11 variable costs by \$0.14 per ton (\$2.51 minus \$2.37).

As discussed above, WFA/Basin's rate is developed quarterly based on the variable costs for the prior quarter multiplied by a STB prescribed R/VC ratio for 2011 of 2.46. Table 2 below compares WFA/Basin's 4Q11 rates calculated using the three iterations of BNSF URCS variable costs described above.

<b><u>Origin</u></b> (1)	<b><u>3Q 2011 Tons</u></b> (2)	<b><u>BNSF Rate Based On BNSF 2010 URCS</u></b>		
		<b><u>As Reported</u></b> <sup>1/</sup> (3)	<b><u>Excluding Acquisition Premium</u></b> <sup>1/</sup> (4)	<b><u>Excluding Acquisition Premium Plus Impact On 2010 COC</u></b> (5)
1. Antelope	447,194	\$4.85	\$4.61	\$4.55
2. Black Thunder	82,532	\$5.59	\$5.34	\$5.27
3. Buckskin	196,622	\$7.22	\$6.92	\$6.83
4. Caballo	244,002	\$6.37	\$6.09	\$6.01
5. Dry Fork	627,723	\$7.01	\$6.72	\$6.63
6. North Antelope	115,109	\$5.07	\$4.82	\$4.76
7. Thunder West	<u>16,541</u>	<u>\$5.77</u>	<u>\$5.51</u>	<u>\$5.43</u>
8. Total/Weighted Average	1,729,723	\$6.18	\$5.90	\$5.83

<sup>1/</sup> Source: Exhibit No. 5 to this VS.

The weighted average rate based on the BNSF 2010 URCS using the BNSF Annual Report Form R-1 data equals \$6.18 per ton (Table 2, Column (3), Line 8). If the BNSF 2010 URCS excluding acquisition premium is utilized, the weighted average rate equals \$5.90 per ton (Table 2, Column (4), Line 8) or \$0.28 per ton less than the rate calculated using the BNSF 2010 unadjusted URCS (\$6.18 per ton minus \$5.90 per ton). If the BNSF 2010 URCS excluding the acquisition premium plus including the impact of including BNSF in the STB's 2010 cost of capital calculation is utilized, the weighted average rate equals \$5.83 per ton (Table 2, Column

(5). Line 8) or \$0.35 per ton less than the rate calculated using the BNSF 2010 unadjusted URCS (\$6.18 minus \$5.83).

The failure to exclude the acquisition premium will increase WFA/Basin's transportation costs over the remaining thirteen years of the STB's prescription period by the amounts shown in Table 3 below.

<p align="center"><b>Table 3</b>  <b>Increase In WFA/Basin's Expected Transportation Costs Associated With</b>  <b>The Inclusion of Berkshire's Acquisition Premium in BNSF's URCS Formulas</b></p>		
<p align="center"><b>Item</b> (1)</p>	<p><b>Estimated Impact Of WFA's</b>  <b>Transportation Charges Of:</b></p>	
	<p><b>Not Excluding</b>  <b>Acquisition</b>  <b>Premium</b> (2)</p>	<p><b>Not Excluding Acquisition</b>  <b>Premium And Not Including</b>  <b>BNSF in The STB 2010 COC</b> (3)</p>
1. WFA/Basin's 4Q11 Weight Average Increased Rate Per Ton 1/	\$0.28	\$0.35
2. WFA/Basin's 4Q11 Increase In Transportation Charges 2/	\$484,322	\$605,403
3. WFA/Basin's Annual Increase In Transportation Charges Based On 4Q11 Experience 3/	\$1,937,288	\$2,421,612
4. WFA/Basin's Increase in Transportation Charges Over The Remaining Term Of STB's Prescription 4/	\$25.2 million	\$31.5 million
<p>1/ Table 2 above and as described in the text following Table 2.                  2/ Line 1 x 1,729,723 tons.                  3/ Line 2 x four quarter per year.                  4/ Line 3 x thirteen remaining years beginning 2012. This analysis excludes the impact of the increasing STB prescribed R/VC ratios (from 2.46 to 2.69) during the remaining term of the STB rate prescription.</p>		

By not excluding the acquisition premium, Table 3, Column (2) demonstrates that WFA/Basin's 4Q11 transportation charges will be increased by \$0.28 per ton (Line 1) or \$484,322 per quarter (Line 2) or \$1.9 million per year (Line 3) or \$25.2 million over the remaining life of the STB's rate prescription period (Line 4).



By not excluding the acquisition premium and not including BNSF in the STB 2010 cost of capital determination, Table 3, Column (3) demonstrates that WFA/Basin's 4Q11 transportation charges will increase by \$0.35 per ton (Line 1) or \$605,403 per quarter (Line 2) or \$2.4 million per year (Line 3) on \$31.5 million over the remaining life of the STB's rate prescription period (Line 4).

**b. Rates Prescribed Under Simplified SAC and Three-Benchmark Approaches**

BNSF shippers with rates prescribed under the SAC constraint will not be the only shippers impacted. The inclusion of the BNSF purchase premium will also impact BNSF shippers with rates prescribed by the STB under its Simplified SAC and Three Benchmark maximum rate methodologies.

The STB adopted in *Simplified Standards*<sup>23</sup> two simpler approaches for captive shippers to contest railroad rates without the need to bring a full SAC presentation. One approach, which the STB designated its Simplified-SAC approach, allows what the STB calls medium-sized shippers, or those seeking less than \$5 million in aggregate relief over 5 years, to contest rail rates using a modified SAC methodology.<sup>24</sup> The second approach, which the STB named its Three-Benchmark methodology, reviews rates by comparing the R/VC ratio for the issue movement to an adjusted R/VC ratio for comparable movements.<sup>25</sup> Inclusion of the BNSF purchase premium in the STB's URCS will impact rate prescriptions under both approaches as both use R/VC ratios for rate prescription purposes.

Like the STB's SAC constraint, *Simplified Standards* calls for the STB to develop the rate prescriptions using the Maximum Markup Methodology ("MMM") in Simplified-SAC

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<sup>23</sup> Ex Parte No. 646 (Sub-No. 1), *Simplified Standards For Rail Rate Cases*, served September 5, 2007 ("*Simplified Standards*").

<sup>24</sup> See *Simplified Standards* at page 13.

<sup>25</sup> See *Simplified Standards* at page 16.

presentations. The MMM approach determines annual maximum prescribed R/VC ratios by determining the maximum contribution from each movement in the traffic group such that the total contribution plus aggregate variable costs would equal the SAC, and with no movement assigned a contribution higher than the rate charged for the movement.<sup>26</sup> This means that, like WFA/Basin, a shipper bringing a rate challenge under the Simplified-SAC approach will receive a prescribed R/VC ratio from the STB and not a prescribed rate per unit. Shippers would then apply the prescribed R/VC ratio to BNSF unadjusted URCS variable costs to develop the prescribed rate per unit. Applying the Simplified-SAC prescribed R/VC ratio to BNSF URCS variable costs containing the purchase premium will explicitly pass along the premium in the prescribed rate.

The STB's Three-Benchmark approach also relies upon a carrier's URCS variable costs to test the reasonableness of a carrier's rate. Under the Three-Benchmark approach, a shipper compares the R/VC ratio for the issue movement to the adjusted average R/VC ratios for a comparison group. If the shipper finds the issue traffic R/VC ratio exceeds that of the adjusted average R/VC ratio for the comparison group, the STB prescribes a maximum R/VC ratio equal to that of the group's adjusted average R/VC ratio.<sup>27</sup>

Inclusion of the purchase premium in BNSF's URCS will impact rate prescriptions under the Three-Benchmark approach in two ways. First, like the SAC and Simplified-SAC approaches, the Three-Benchmark approach does not develop a specific prescribed rate per unit, but rather prescribes a maximum R/VC ratio that the shipper then applies to the movement's URCS variable costs. Applying the prescribed R/VC ratio to BNSF URCS variable costs that

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<sup>26</sup> See *Major Issues* at 11.

<sup>27</sup> See *Simplified Standards* at 16.

include the impact of the purchase premium will directly pass the premium through to the shipper in the form of a higher prescribed rate.

Second, as part of the Three-Benchmark approach, parties make adjustments to the comparison group's average R/VC ratio based upon the railroad's revenue shortfall allocation method ("RSAM") ratio. The STB calculates each railroad's RSAM ratio by developing the aggregate revenue for movements with R/VC ratios greater than 180 percent (" $R/VC_{>180}$ "), adding to this the tax adjusted revenue necessary to bring the railroad to a revenue adequate level (" $\text{Adjusted Rev}_{\text{short/overage}}$ ")<sup>28</sup>, and dividing this sum by the aggregate URCS variable costs for movements with R/VC ratio greater than 180 percent (" $VC_{>180}$ ").<sup>29</sup>

The  $\text{Adjusted Rev}_{\text{short/overage}}$  is a key component of the RSAM ratio used in the Three-Benchmark method. The STB calculates the  $\text{Adjusted Rev}_{\text{short/overage}}$  based on data submitted by the railroads in their Schedule 250 as part of the STB's annual revenue adequacy determination. The railroads develop their Schedule 250 data using the same data used to develop the financial statements included in the Annual Report Form R-1 submitted to the STB. In the case of the BNSF, this means developing Schedule 250 data that includes the impact of the Berkshire acquisition. Specifically, the Berkshire acquisition impacts the Schedule 250 data by increasing the BNSF's net investment base by the premium paid over the book value of the BNSF's road and equipment assets. This increase in the net investment base decreases the BNSF's tax adjusted ROI and moves the BNSF further away from a regulatory revenue adequate position.

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<sup>28</sup> The STB's original decision in *Simplified Standards* called for developing a railroad's RSAM ratio without adjusting the  $\text{Rev}_{\text{short/overage}}$  for taxes. See *Simplified Standards* at page 20.

<sup>29</sup> See STB Ex Parte No. 646 (Sub-No. 2), *Simplified Standards For Rail Rate Cases – Taxes in Revenue Allocation Shortfall*, served November 21, 2008 ("*Simplified Standards Tax Decision*")

Pushing the purchase premium down to BNSF's financial statements causes the BNSF's tax-adjusted ROI to decrease from 10.05 percent to 9.22 percent in 2010.<sup>30</sup>

The implication of the lower ROI percentage is significant in that a smaller ROI percentage will lead to a larger Adjusted Rev<sub>short/overage</sub>, which will in turn create a larger RSAM ratio applied in a Three-Benchmark case. In other words, including the purchase premium in the BNSF's Annual Report Form R-1 financial statements will lead to higher adjusted R/VC ratios under the Three-Benchmark methodology, which will directly impact small shippers seeking rate relief from the STB.<sup>31</sup>

## **2. Impact On BNSF Shippers Seeking Rate Prescriptions**

The STB can only consider the reasonableness of a rail rate if the carrier has market dominance over the traffic involved. In addition, federal law precludes the STB from finding market dominance where the carrier shows that the revenues produced by the movement are less than 180 percent of the variable costs to the carrier for providing the service. Anything that would artificially increase a carrier's variable cost on a movement would reduce the movement's R/VC ratio. Such adjustments could lower the movement's R/VC ratio below the 180 percent jurisdictional threshold, and remove a shipper's ability to seek rate relief from the STB.

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<sup>30</sup> We have included our adjustments to the BNSF's Schedule 250 in our workpapers to this VS (see "Adjusted Schedule 250 workpapers .xlsx"). BNSF's Schedule 250 filed with the STB and the BNSF's workpapers supporting its asset write-up and depreciation calculations used to develop its Annual Report Form R-1 financial statements. A comparison of the BNSF's Annual Report Form R-1 schedules and its Schedule 250 shows that while Schedule 250 is nominally prepared using data from the Annual Report Form R-1, many of the BNSF's financial figures in the two statements do not match. The STB staff member responsible for collecting and analyzing the railroad's Annual Report Form R-1 and Schedule 250s indicated that due to slightly different consolidation procedures, a railroad's Annual Report Form R-1 and Schedule 250 figures may not match even though they are both produced from the same data.

<sup>31</sup> The decline in the BNSF's ROI has a potentially longer term impact on SAC rate cases as well. Railroads deemed long-term revenue adequate under STB guidelines lose certain regulatory pricing freedoms. Including the acquisition premium in the BNSF's revenue adequacy workpapers will decrease the BNSF's ROI and move it further away from being declared revenue adequate.

As discussed above, Berkshire's pushdown of its acquisition premium to the BNSF's books will increase BNSF's URCS variable costs. This increase in URCS variable costs will impact shippers seeking relief from the STB by pushing some movement R/VC ratios below the 180 percent jurisdictional threshold. This will lead to a decline in the number of shippers who may seek rate relief from the STB. It will also lead to higher rates for these shippers as BNSF can increase rates without fear of breaching the jurisdictional threshold. The end result is higher rates and less regulatory protection for a section of captive shippers.

### **3. Impact On Rate Negotiations and Competitive Shippers**

It is abundantly clear based on the facts we discuss above that pushing down the premium over book value that Berkshire paid for BNSF will impact rates under the STB's jurisdiction. The inclusion of the premium will also have an impact on rate negotiations and subsequent rates for so-called competitive shippers as well.

The STB indicated in *Major Issues* that one benefit of the STB's MMM rate reduction methodology is an ability to facilitate rate case settlements and private rate negotiations. The STB believed that:

The maximum contribution level [over URCS variable costs] in a particular case would provide information parties could use to predict the outcome of their disputes, because the maximum contribution level would be independent of the level of the rate the railroad might set should negotiations break down. Such information should help parties negotiate a mutually agreeable rate.<sup>32</sup>

In the case of shippers negotiating with the BNSF, application of the STB's standards will lead to higher negotiated rates since the standards rely in large part upon URCS variable

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<sup>32</sup> See *Major Issues* at page 12.

costs, which have been impacted by the acquisition premium pushed down to BNSF's financial statements.

In addition, the pushdown of the premium over book value will impact so-called competitive rates. BNSF President and CEO Mathew Rose has said competitive rates should be higher than captive rates. As indicated by Mr. Rose:

“... one of the reasons that we have had pressure from customers and markets is that the percent of captive traffic produced a higher margin than the non-captive traffic to, in some cases, 20, 25, 30% and that cost caused a lot of disconcert. And I can see us in a period of time in the future, where non-captive traffic will actually return significantly more than captive traffic<sup>33</sup>

If we are to hold Mr. Rose's comments to be true, any increase in captive shipper rates brought about by inclusion of the merger premium will impact competitive rates as BNSF attempts to push competitive rates to captive levels.

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<sup>33</sup> See Corrected Transcript from the JP Morgan Aviation & Transportation Conference, March 11, 2009, p. 10)

**V. EXCLUSION OF THE BNSF ACQUISITION PREMIUM IS PROPER**

As we discussed above, Berkshire accounted for its acquisition of BNSF using the Acquisition Accounting method, which resulted in a significant write-up in BNSF's assets due to Berkshire paying a premium above BNSF's book value for the railroad company. Berkshire then pushed down its acquisition premium to the railroad company's financial statements. Pushing down the premium subsequently leads to higher BNSF URCS variable costs as the STB uses data from acquisition adjusted Annual Report Form R-1 data to annually update its URCS tables.

Berkshire's approach for accounting for its acquisition is consistent with Generally Accepted Accounting Principles ("GAAP") and SEC reporting guidelines. Yet other, non-accounting considerations must come into play when deciding how to treat BNSF's acquisition. Unlike prior railroad acquisitions, Berkshire's acquisition of BNSF will lead to no material cost savings that would offset the premium that flows through to the URCS variable costs. As discussed above, this means that the purchase premium will fall directly to shippers with rates dependent about BNSF URCS variable costs. Other regulatory agencies recognize that ratepayers only benefit from mergers and acquisitions when premiums are offset by cost saving synergies. In these situations where little or no synergies exist, these other regulatory agencies would not allow the acquired company to roll all or part of the premium into the rate base.

The STB has the discretion to do the same thing in this instance. While railroad accounting principles developed by the Railroad Accountings Principles Board ("RAPB") generally encourage the use of GAAP when developing railroad financial statements, the RAPB allows for other cost bases, especially for ratemaking purposes. The STB has the authority to modify railroad financial reporting and URCS for ratemaking purposes and should exercise this authority here because it is fundamentally unfair to have rates go up, jurisdictions lessened due solely to change in ownership.

Finally, the STB must exclude the premium paid above book value if it wishes to be consistent with prior precedent and SAC principles. The STB chose to switch from prescribing fixed rates per unit after determining the reasonableness of a railroad's rate to prescribing R/VC ratios to allow for prescribed rates to adjust for changes in railroad operating costs. As we detailed above, BNSF has indicated that its operations will not change because of the Berkshire acquisition, and can therefore expect no changes in operating costs from the acquisition. Yet, flowing through the premium to URCS will directly impact shipper's prescribed rates without a corresponding change in operations.

**A. BERKSHIRE'S ACQUISITION  
OF BNSF IS UNLIKE OTHER  
RAILROAD ACQUISITIONS**

The Berkshire acquisition of BNSF differs from past railroad acquisitions and mergers as those proceedings related to the impact on the railroad's URCS variable costs. The STB has previously justified the premium paid based on the expected synergies of the merger. As shown below, assuming what the STB expected as the value for the annual cost savings related to the merger synergies, the impact of the premium would be recovered in a few years. In BNSF's reply to WCTL's motion to begin this proceeding, the BNSF asserted that ICC/STB has accepted the acquisition premium costs in past proceedings. As discussed below, the BNSF's position is misplaced.

**1. Comparison of Expected Synergies to the Acquisition Premium**

The STB has in past merger proceedings expected that the synergies from the merger would offset, at some point in time, the premium paid and any increase in variable costs caused



by the premium.<sup>34</sup> Because of the expected cost savings due to the synergies, the STB chose not to remove the premium from the URCS variable costs in these prior merger proceedings. Table 4 below compares the annual cost savings projected by the STB with the premium that was included in URCS following the merger for the last three Class I mergers (NS/CSXT acquisition of Conrail, UP/SP merger and BN/ATSF merger).

<u>Merger</u> (1)	<u>Amount (Millions)</u>		<u>Years To Recover Premium</u> <sup>2/</sup> (4)
	<u>Projected Cost Synergies Per Year</u> (2)	<u>Acquisition Premium</u> <sup>1/</sup> (3)	
1. NS/CSXT-Conrail	\$1,000	\$3,671	3.7
2. UP-SP	\$659	\$2,729	4.1
3. BN-ATSF	<u>\$453</u>	<u>\$1,423</u>	<u>3.1</u>
<sup>1/</sup> Net premium included in URCS.			
<sup>2/</sup> Column (3) – Column (2).			

As shown above in Table 4, the ICC/STB expected recent mergers to result in cost savings, which also translate into variable cost savings, ranging from \$453 million to \$1,000 million per year. For these mergers, the acquisition premium that flowed through to URCS costs ranged between \$1,423 million and \$3,671 million. If these cost savings did occur, the breakeven for the recovery of the acquisition premium ranges between 3.1 years and 4.1 years. This is far different than the acquisition premium of over \$8.1 billion that is to be included in the 2010 BNSF URCS based on the Berkshire Hathaway purchase. No cost savings exist to offset the premium and, thus, the recovery time period does not exist. Stated differently, shippers will never see cost saving related to any synergies due to the Berkshire purchase.

<sup>34</sup> See for example *Conrail Acquisition* at page 263.

In addition, the \$8.1 billion premium included in BNSF's assets is more than double the largest premium in any recent merger case. When compared to the BN merger with AT&SF, the Berkshire Hathaway premium is more than 5 times the premium paid in that merger.

## **2. Inclusion of Premium in Chicago and North Western Acquisition**

BNSF's reply to WCTL's Petition to begin this proceeding asserts that the STB has accepted the inclusion of acquisition costs in proceedings that did not involve the merger of railroads. Specifically, BNSF states that when the Blackstone Group ("Blackstone") acquired the Chicago and North Western Transportation Company ("CNW") there "was no discussion in the ICC's decision of the 'acquisition premium' Blackstone paid or any merger synergies offsetting the acquisition cost."<sup>35</sup> The BNSF Reply misstates the financial aspects of Blackstone's acquisition and the ICC's evaluation of the acquisition.

The primary concern in the Blackstone/CNW transaction was CNW's ability to perform as a railroad after the leveraged buyout occurred. As ICC Commissioner Phillips commented in the decision granting the acquisition, the "central issue" was CNW's "...post transaction ability to service the debt while continuing to provide essential service to the public."<sup>36</sup> As part of the ICC's order in the proceeding, CNW<sup>37</sup> was required to "...file with the Commission the terms of all financial covenants relating to minimum net worth, working capital, tangible net worth, interest coverage, and leverage ratio upon consummation and submit quarterly status reports of their compliance with the covenants."<sup>38</sup> The issue of a premium on the cost of service for CNW was not specifically raised in the proceeding.

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<sup>35</sup> See BNSF Reply at page 5.

<sup>36</sup> See 5 ICC 2d, 1047.

<sup>37</sup> The order applied to CNW's subsidiary Midwestern Rail Properties, Inc. also.

<sup>38</sup> See 5 ICC 2d, 1050.

BNSF asserts that the ICC decision in the Blackstone acquisition of the CNW did not address any cost savings or synergies that offset the acquisition costs. This is incorrect. As part of its submissions in the case, CNW provided a proposed “Business and Operating Plan” for its post-acquisition operations. As part of this plan, CNW anticipated cost reductions of \$54 million in 1990 from reductions in overhead costs and the elimination of the bonus program for senior management.<sup>39</sup> In addition to these cost savings, CNW anticipated annual cost savings, by full implementation in 1992, of \$48 million as well as an additional cash benefit from the sale of land and rolling stock of \$60 million.<sup>40</sup> Stated differently, Blackstone’s acquisition of CNW was intended to have substantial financial benefit to CNW.

BNSF’s argument regarding the Blackstone acquisition of CNW also ignores the fact that the transaction resulted in little, if any, acquisition premium that would have impacted variable cost calculations. In its 1989 R-1, CNW stated;

[The acquisition was] accounted for using the purchase method of accounting. The excess of the purchase price over the net book value of CNW was approximately \$405 million and in accordance with generally accepted accounting principles, such excess has been allocated to the Company’s assets and liabilities based upon information currently available with respect to their fair values.<sup>41</sup>

The fact is that end of year net investment in road property and equipment increased by \$90 million (or 8 percent) between 1988 and 1989.<sup>42</sup> Then, in 1990, the end of year net investment decreased to the 1988 levels.

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<sup>39</sup> See 5 ICC 2d, 1034

<sup>40</sup> See 5 ICC 2d 1035.

<sup>41</sup> \$201 million was allocated to a non-Class I carrier, the Western Railroad Properties Inc.

<sup>42</sup> Association of American Railroads, “Analysis of Class I Statistics,” Line 111. 1988 equaled \$1.095 billion and 1989 equaled \$1.185 billion.

Annual depreciation, which was impacted by the revaluation of the assets, did increase from \$41.4 million in 1988 to \$44.7 million in 1989, an increase of 8 percent.<sup>43</sup> However, by 1991, the annual depreciation had decreased to \$43.4 million, \$1.3 million less than the 1989 levels.

Based on the changes in net investment and depreciation that occurred after the Blackstone acquisition, it is clear that CNW's URCS costs would not have been impacted in any substantial way. In fact, the anticipated cost savings, which by 1992 would equal over \$100 million, were estimated to exceed any premium due to the Blackstone acquisition of CNW.

**B. OTHER REGULATORY  
AGENCIES EXCLUDE  
ASSET WRITE-UPS**

The ICC and STB have previously allowed railroads to include the write-up in asset values from acquisitions and mergers in the railroads' regulatory rate bases on the premise that the cost of these increases would be off-set by cost saving synergies. As noted in a recent joint study performed by the United States Department of Agriculture ("USDA") and the United States Department of Transportation ("USDOT"), the ICC and STB are the only regulatory agencies to allow asset write-ups as part of mergers and acquisitions to be included in a company's rate base.<sup>44</sup>

The Federal Energy Regulatory Commission ("FERC") will only allow the inclusion of purchase premiums over book value where significant costs savings from the transaction will occur to offset the increase in the rate base. Where these savings are not expected to be gained, FERC disallows the premium pass through. For example, when the Michigan Electric

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<sup>43</sup> Association of American Railroads, "Analysis of Class I Statistics," Line 172 + Line 180 + Line 188 + Line 196.

<sup>44</sup> See "Study of Rural Transportation Issues," United States Department of Agriculture and United States Department of Transportation, April 2010 at page 263.

Transmission Company purchased transmission assets, FERC ordered that the difference between the net book value of the Transmission Assets and the purchase price of the Transmission Assets be recorded to a non-rate base account acquisition adjustment and amortized to a non-recoverable expense account over the remaining life of the underlying assets acquired.<sup>45</sup> Consistent with this approach, FERC also held that the Missouri Pipeline Company, LLC, (“MoGAS”) had fairly instituted its rates by not including premiums to be passed onto the ratepayers.<sup>46</sup>

It is also common practice for Public Utility Commissions (“PUC”) nationwide to disallow acquisition premiums to be included in the rate making process. For example, the California PUC stated that in the case of California water companies, “[a]s part of this proceeding, the ratepayers of Suburban shall not incur financial obligations due to any premium paid by the purchasing Applicants for the acquisition of SouthWest or Suburban.”<sup>47</sup> Similarly, the Pennsylvania PUC stated that “the recording of any amount for such acquisition premium on Columbia's books of account shall have no effect on the ratemaking treatment of such amount in future rate proceedings.”<sup>48</sup>

These actions are consistent with the regulatory agencies responsibilities to balance the needs of the ratepayers with those of other parties, including investors. Where the inclusion of

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<sup>45</sup> Federal Energy Regulatory Commission, Michigan Electric Transmission Company, LLC, Application for the Approval of Acquisition of Transmission Asset Pursuant to Section 203 of the Federal Power Act, <http://elibrary.ferc.gov/idmws/search/results.asp>.

<sup>46</sup> Federal Energy Regulatory Commission, Michigan Electric Transmission Company Reply Brief of Mogas Pipeline, LLC., <http://elibrary.ferc.gov/idmws/search/results.asp>.

<sup>47</sup> California Public Utilities Commission . Joint Application of Suburban Water Systems (U339W), SouthWest Water Company, SW Merger Acquisition Corp., IIF Subway Investment LP, and USA Water Services, LLC for Commission Authorization of a Transfer of Indirect Control of Suburban Water Systems, A.10-04-009, (Filed April 6, 2010), <http://docs.cpuc.ca.gov/cfile/MOTION/120728.pdf>.

<sup>48</sup> Pennsylvania Public Utility Commission, In the Matter of the Application of Columbia Gas of Pennsylvania, Inc. for a Certificate of Public Convenience Evidencing Approval under Section 1102(a)(3) of the Public Utility Code of the Transfer from Columbia Energy Group to NiSource Inc. Or New NiSource Inc., by Merger, of the Title to and Possession and Use of All Property of Columbia Gas of Pennsylvania, Inc., June 28, 2000, [www.puc.state.pa.us/pdocs/264243.doc](http://www.puc.state.pa.us/pdocs/264243.doc).

the premium paid above book value will disproportionately fall upon the ratepayers, FERC and state PUC's have limited the ability of the purchasing companies to pass on these costs.

**C. THE STB HAS THE  
ABILITY TO EXCLUDE  
THE PREMIUM**

The STB has the authority to modify railroad financial reporting and URCS costs for ratemaking purposes and should exercise this authority in this instance. Unlike prior railroad mergers, Berkshire and BNSF have not forecasted any synergies from the acquisition, and have clearly indicated they expected no changes to the railroad's operations. The STB should exercise its discretion and authority as do other regulatory agencies to protect ratepayers when they will not benefit from the acquisition. It is fundamentally unfair to have rates go up and jurisdictions lessened due solely to change in ownership.

**1. The STB Has The Authority To Adjust URCS Variable Costs**

The STB has the statutory right to adjust its URCS variable cost calculations to remove the impact of the BNSF purchase premium brought about by the Berkshire acquisition. 49

U.S.C. § 10707 addresses the calculation of market dominance in rail rate proceedings, and says in pertinent part:

For purposes of this section, variable costs for a rail carrier shall be determined only by using such carrier's unadjusted costs, calculated using the Uniform Rail Costing System cost finding methodology (or an alternative methodology adopted by the Board in lieu thereof) and indexed quarterly to account for current wage and price levels in the region in which the carrier operates, with adjustments specified by the Board.<sup>49</sup>

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<sup>49</sup> See 49 U.S.C. § 10707(d)(1)(B).

The federal statute provides the STB the authority to make “adjustments specified by the Board.”

Prior to its decisions in *Major Issues* and *Simplified Standards*, parties participating in rate proceedings before the STB made numerous adjustments to URCS variable costs. Parties made these adjustments for numerous reasons, including to refine train and operations statistics and to adjust accounting figures. After its *Major Issues* and *Simplified Standard* decisions came into effect, the STB eliminated nearly all adjustments to URCS variable costs in rate proceedings. However, the STB makes adjustments in some limited situations.

While the STB calls for the use of the unadjusted URCS Phase III variable costs in nearly all aspects of SAC cases, the STB makes adjustments to remove interchange costs when calculating Average Total Cost (“ATC”) divisions on cross-over traffic moving over the stand-alone railroad (“SARR”). The STB removes the interchange costs from its URCS calculations since it believes that in a full-SAC analysis, there would be no interchange between the hypothetical SARR and the incumbent carrier.<sup>50</sup> To adjust for what the STB called “phantom interchanges,” the STB requires the parties to calculate the unadjusted URCS Phase III variable costs for the on-SARR and off-SARR portions of the movements, and to subtract the URCS system-average interchange costs. It is clear that the STB has the authority and the willingness to make adjustments to URCS variable costs.

## **2. Adjustments To BNSF’s Financial Statements and URCS Are Compatible With Railroad Accounting Principles**

The STB indicated in The *Conrail Acquisition* decision that the use of the Acquisition Accounting approach conformed with the RAPB’s recommendation of using acquisition costs instead of book costs.<sup>51</sup> While the RAPB generally recommended the use of GAAP costs for

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<sup>50</sup> See *W.F.A. Basin* September 2007 decision at page 12

<sup>51</sup> See *Conrail Acquisition* decision at page 262.

business combinations, it also indicated that the ICC, and now STB, could determine that GAAP did not produce meaningful regulatory results in certain situations. The STB considered several of these arguments in CSXT/NS's acquisition of Conrail but decided that the Acquisition Accounting approach was still appropriate since any costs increases that passed through to URCS would be mitigated by cost saving synergies that were expected to flow through the system.

Much has changed since the STB's *Conrail Acquisition* decision. As discussed in great detail above, Berkshire's acquisition of BNSF is different than the Conrail acquisition and other mergers as no significant synergies are expected to accrue. Just as importantly, the STB has now commingled its once separate cost and ratemaking functions so that the STB's costing practices have a direct impact on rate prescriptions beyond the determination of the jurisdictional threshold. These changes dictate that the STB must reconsider the impact the full application of Purchase Approach of accounting and push down accounting has on shippers.

#### **a. Railroad Accounting Principles Allow For Deviation From GAAP**

Railroad accounting principles generally call for the use of GAAP when developing railroad financial statements. This extends to the use of Purchase Accounting wherein the RAPB believed that this methodology better reflected economically accurate costs.<sup>52</sup> RAPB recognized, however, that GAAP did not always provide meaningful regulatory results. Because of this, RAPB allowed the ICC, and now the STB, the flexibility to deviate from GAAP when needed to

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<sup>52</sup> See Railroad Accounting Principles Final Report, September 1, 1987, Volume 2 ("RAPB – Volume 2") at page 45. The RAPB also discussed the appropriateness of using the Pooling of Interests accounting approach when applicable. The Pooling of Interest approach accounted for business combinations as an exchange in equity securities by the combining companies, with the recorded assets and liabilities of the combining companies carried forward at their previously recorded amounts. The Code of Federal Regulations still allows railroad companies to account for business combinations using the Pooling of Interest approach (See 49 CFR 1201.2-15), but GAAP no longer allows companies to use the approach.



met its regulatory responsibilities.<sup>53</sup> We believe Berkshire's acquisition of the BNSF is one of the exceptions when the STB should exercise its discretion to use a valuation approach other than GAAP.

i. Railroad Values Are Greatly Influenced by Regulation

RAPB recognized that most public utility commissions use predecessor costs, or the costs before the allocation of the purchase premium, rather than acquisition costs to preclude upward or downward manipulation of asset values.<sup>54</sup> RAPB believed that such actions would only be necessary in the railroad industry if the market value of the railroad firms were established "predominantly" through regulatory policy. To assess whether a company's value was determined by regulatory policy, RAPB referenced two standards that parties could use to test the impact of regulatory policy on values. One standard looked at whether a material portion of the regulated company's rates are influenced by what regulators allow. In the alternative, the second standard reviewed whether the value of the regulated enterprise could be driven to depressed levels by improper regulation.

We believe that the value of today's railroads is greatly dependent upon regulatory issues. Support for this position comes from the railroads themselves. The first standard calls for assessing whether market value is determined by regulatory policy by determining if a "material" portion of the regulated company's rates are influenced by what the regulators allow. In other words, are regulated rates a material portion of a railroad's business?

RAPB provides no definition of "material". Assuming that material can be defined as significantly impacting railroad revenue and earnings, then regulated rates are a material portion of current railroad businesses. This point is supported by the railroads themselves in addressing

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<sup>53</sup> See RAPB – Volume 2 at page 46.

<sup>54</sup> Id.

how adverse regulations and maximum rate decisions can deeply impact railroad revenues and earnings. BNSF's John Lanigan stated in testimony before the STB in *Ex Parte No. 658*:<sup>55</sup>

When I speak of rate regulation, I refer in particular to coal rate cases, several of which involving BNSF are still pending before the Board. Because of the huge amounts at stake in individual cases, there is a real danger that an over-zealous or inappropriate application of maximum rate standards could impair our prospects of attaining revenue adequacy....The Board's maximum rate authority should not be used to prevent BNSF the revenues needed to maintain and expand the railroad network .<sup>56</sup>

If we take Mr. Lanigan's statement at face value, regulated coal traffic has a great impact on BNSF's ability to attain revenue adequacy, to maintain its current operations and to expand its network. This position strongly supports the idea that regulated traffic materially impacts BNSF's value.

If the amount of traffic covered by regulation is sufficient to impact a railroad's operations, maintenance and network investment, it must be of sufficient magnitude to be considered a "material" portion of a company's revenue base, and therefore, an impact on market value. The AAR supports the materiality of regulated rail rates. In a recent position paper, AAR stated:

New heavy-handed regulation would send railroads back down the wrong track – away from financial stability. It would force railroads to lower their rates to certain favored shippers to below-market levels at the expense of other shippers, rail employees and the public at large. Several billion dollars in rail revenue could be lost each year .<sup>57</sup>

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<sup>55</sup> *Ex Parte No. 658, The 25<sup>th</sup> Anniversary of the Staggers Rail Act of 1980 – A Review and Look Ahead* ("Ex Parte 658").

<sup>56</sup> Statement of John P. Lanigan in *Ex Parte 658*, at pages 23-24.

<sup>57</sup> See "Rail Earnings Today Pay For Capacity and Service Improvements For Tomorrow," AAR, April 2011.

According to the AAR, regulated railroad traffic runs into the billions of dollars per year.

Obviously regulated traffic materially impacts the railroads.

The second test of regulatory policies impacting values is also met by the current railroads. RAPB stated that regulatory policy has a material impact on railroad value if the regulated enterprise's value could be driven down by improper regulations. Railroad industry executives have stated numerous times that improper economic regulation would materially impact their railroad company's ability to increase revenues and returns, both of which are directly linked to railroad value. As summarized by James R. Young, President and Chief Operating Officer of UP:

Government economic regulation directly affects railroad returns. As a result, it will directly affect the extent of investment by the railroad industry and directly influence or constrain the size of the future rail system....Regulation and policies that investors view as undermining adequate returns will reduce or limit the investments investors are willing to make.<sup>58</sup>

A company's market value is dependent upon the return it brings to its shareholders. Companies that have lower returns by definition are less valuable than companies with higher returns. As the STB has noted in its cost of capital proceedings, the value of a company's common equity is equal to the discounted value of its future cashflow available to investors.<sup>59</sup> As UP's Mr. Young indicates, current government economic regulations can impact the stream of returns available to investors and will thereby impact the market value of the railroads.

The simple fact is that railroad executives have testified before the STB that improper regulation imposed on the railroads could depress railroad values. RAPB believed such

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<sup>58</sup> Statement of James R. Young in *Ex Parte* 658.

<sup>59</sup> See STB decision in *Ex Parte* No. 664 (Sub No. 1), *Use of a Multi-Stage Discounted Cash Flow Model in Determining the Railroad Industry's Cost of Capital*, served January 28, 2009 at page 5, "The cost of equity in a DCF model is the discount rate that equates a firm's market value to the present value of the stream of cash flows that could affect investors."

influence was a clear indication that railroad market value is established by regulatory policy, and as such, meets one of the standards the RAPB viewed as a reason to use measures other than GAAP in certain situations.

ii. The STB Has Comingled Its Ratemaking and Costing Authorities

RAPB also discounted the use of historic costs because it believed at the time that concerns about circularity between rates and acquisition costs were unfounded.<sup>60</sup> The RAPB indicated that for circularity issues to be pertinent, the regulated enterprises must possess sufficient market power that rates are materially affected by what the regulator allows. In addition, the ICC, or now the STB, would have to use GAAP costs directly in ratemaking.

The railroads have indicated that their rates are materially affected by the STB's actions as indicated above. The second factor that comes into play to complete RAPB's circularity arguments is whether or not the STB uses GAAP costs directly in its ratemaking authority. With the STB's adoption of *Major Issues* and *Simplified Standards*, the answer to this inquiry is "yes".

The STB stated that it chose to adopt the MMM approach to rate prescriptions in SAC cases because expressing SAC rates as R/VC ratios is a relatively simple calculation using URCS variable costs:

Moreover, expressing the SAC rate as maximum R/VC ratio is a relatively simple task, using unadjusted URCS to cost each movement....<sup>61</sup>

For the same reasons set forth in *Major Issues*, the STB chose to use the MMM approach to establish prescribed rates under its Simplified-SAC maximum rate procedures.<sup>62</sup> Like the MMM approach used in SAC and Simplified-SAC procedures, the STB's Three-Benchmark

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<sup>60</sup> See RAPB – Volume 2 at pages 46 - 47.

<sup>61</sup> See *Major Issues* at pages 14 - 15.

<sup>62</sup> See *Simplified Standards* at pages 64 - 65.

approach also prescribes maximum R/VC ratios using URCS variable costs instead of prescribing a set rate per unit.<sup>63</sup> The STB uses unadjusted URCS variable costs, to set prescribed rates under all of its maximum rate procedures currently in use.

As we demonstrated above, the STB's URCS relies directly upon the financial and operating characteristics included in the railroads' Annual Reports Form R-1 developed under GAAP. Operating costs and investment costs which the railroads prepare under GAAP feed directly into the STB's URCS formulas, which the STB then utilizes to prescribe rates for shippers in maximum reasonable rate cases. There is an undeniable direct link between the STB's ratemaking and GAAP. This leads to the circularity in rates and acquisition costs the RAPB thought did not exist at the time it published the Railroad Accounting Principles, but now clearly exists.

**D. INCLUSION OF THE  
PREMIUM IS  
INCONSISTENT WITH SAC CASES**

After the STB issued its *WFA/Basin* February 2009 decision, WFA/Basin filed a petition for reconsideration seeking to address several issues including the appropriate variable costs to use in developing the quarterly or annual prescribed rates. WFA/Basin asserted that the STB must use the same variable costs used in the SAC MMM model to develop the prescribed rates. Doing otherwise would lead to a disconnect between the SAC assumptions and the SAC rates and could lead to a windfall for BNSF.

The STB ruled against WFA/Basin's reconsideration petition in its July 2009 decision.<sup>64</sup> The STB stated that it rejected WFA/Basin's position because the STB specifically choose to

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<sup>63</sup> See *Simplified Standards* at pages 16 - 21.

<sup>64</sup> See STB Docket No 42088 (Sub-No. 1), *Western Fuels Association Inc , and Basin Electric Power Cooperative v BNSF Railway Company*, served July 23, 2009 ("*WFA Basin July 2009*") decision at pages 7 to 9.

prescribe R/VC ratios instead of rates per unit to allow for self-adjustments as operating cost changes:

Thus, there is a need for flexibility in rate prescriptions so that they can be self-adjusting as operating expenses change, while continuing to provide a reasonable constraint on the pricing of the railroad. We believe this approach of setting the maximum R/VC ratios based on the best forecast of record – but then letting the actual maximum lawful rates adjust with changes in actual operating expenses – provides the appropriate balance of competing concerns.<sup>65</sup>

The STB's clear intent in stipulating the use of "self-adjusting" maximum rates was to insure that changes in the incumbent railroad's operating costs would be included in future rate levels. If the STB is going to be consistent in its ruling, it must exclude the purchase premium because the purchase will have no impact on the BNSF's operations and operating costs. BNSF management has repeatedly indicated that the Berkshire acquisition was a pure financial transaction, and no changes in BNSF operations would occur as part of the purchase. The change in the BNSF's URCS variable costs has nothing to do with changing operating conditions or changes in previous forecasts, but instead is entirely due to a change in ownership interests.

The STB stated that prescribing a R/VC ratio instead of a fixed rate provides flexibility so that rates reflect changes in operating costs, yet constrain railroad pricing. In this instance though, there has been no change in operations, yet WFA/Basin's rate will increase. Instead of constraining rates, inclusion of the premium forces WFA/Basin to pay more simply because Berkshire paid a premium for BNSF. Such an outcome is inconsistent with basic SAC principles. The ICC determined in *Coal Guidelines*<sup>66</sup> that a shipper should not bear the costs of any

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<sup>65</sup> See *WFA/Basin* July 2009 decision at page 8.

<sup>66</sup> *Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines, Nationwide*, 1 ICC 2d (520) ("Coal Guidelines"),

facilities or services from which it derives no benefit.<sup>67</sup> As we have discussed extensively throughout this VS, BNSF clearly has not changed its operations because of the Berkshire acquisition, and BNSF itself has indicated no changes are expected. The premium paid by Berkshire for BNSF provides no benefits for the railroad's shippers. Therefore, the premium paid must be disregarded when considering rates under the SAC constraint.

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<sup>67</sup> See *Coal Guidelines* at page 523.


## VERIFICATION

COMMONWEALTH OF VIRGINIA )  
 )  
CITY OF ALEXANDRIA )

I, THOMAS D. CROWLEY, verify under penalty of perjury that I have read the foregoing Verified Statement of Thomas D. Crowley, that I know the contents thereof, and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.

Thomas D. Crowley  
Thomas D. Crowley

Sworn to and subscribed  
before me this 28<sup>th</sup> day of October, 2011

  
Helen Mary Lunsford  
Notary Public for the State of Virginia


My Commission Expires: November 30, 2015  
Registration Number: 7507963



## VERIFICATION

COMMONWEALTH OF VIRGINIA )  
CITY OF ALEXANDRIA )

I, DANIEL L. FAPP, verify under penalty of perjury that I have read the foregoing Verified Statement of Daniel L. Fapp, that I know the contents thereof, and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.

  
Daniel L. Fapp

Sworn to and subscribed  
before me this day 28<sup>th</sup> day of October, 2011.

Diane R. Kavounis  
Diane R. Kavounis  
Notary Public for the State of Virginia

**My Commission expires: November 30, 2012**  
**Registration Number: 7160645**

**STATEMENT OF QUALIFICATIONS**

My name is Thomas D. Crowley. I am an economist and President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, Virginia 22314, 760 E. Pusch View Lane, Suite 150, Tucson, Arizona 85737, and 21 Founders Way, Queensbury, New York 12804.

I am a graduate of the University of Maine from which I obtained a Bachelor of Science degree in Economics. I have also taken graduate courses in transportation at George Washington University in Washington, D.C. I spent three years in the United States Army and since February 1971 have been employed by L. E. Peabody & Associates, Inc.

I am a member of the American Economic Association, the Transportation Research Forum, and the American Railway Engineering and Maintenance-of-Way Association.

The firm of L. E. Peabody & Associates, Inc. specializes in analyzing matters related to the rail transportation of all commodities. As a result of my extensive economic consulting practice since 1971 and my participation in maximum-rate, rail merger, service disputes and rule-making proceedings before various government and private governing bodies, I have become thoroughly familiar with the rail carriers that move coal over the major coal routes in the United States. This familiarity extends to subjects of railroad service, costs and profitability, cost of capital, railroad capacity, railroad traffic prioritization and the structure and operation of the various contracts and tariffs that historically have governed the movement of traffic by rail.

**STATEMENT OF QUALIFICATIONS**

As an economic consultant, I have organized and directed economic studies and prepared reports for railroads, freight forwarders and other carriers, for shippers, for associations and for state governments and other public bodies dealing with transportation and related economic problems. Examples of studies I have participated in include organizing and directing traffic, operational and cost analyses in connection with multiple car movements, unit train operations for coal and other commodities, freight forwarder facilities, TOFC/COFC rail facilities, divisions of through rail rates, operating commuter passenger service, and other studies dealing with markets and the transportation by different modes of various commodities from both eastern and western origins to various destinations in the United States. The nature of these studies enabled me to become familiar with the operating practices and accounting procedures utilized by railroads in the normal course of business.

Additionally, I have inspected and studied both railroad terminal and line-haul facilities used in handling various commodities, including unit train coal movements from coal mine origins in the Powder River Basin and in Colorado to various utility destinations in the eastern, mid-western and western portions of the United States and from the Eastern coal fields to various destinations in the Mid-Atlantic, northeastern, southeastern and mid-western portions of the United States. These operational reviews and studies were used as a basis for the determination of the traffic and operating characteristics for specific movements of numerous commodities handled by rail.

**STATEMENT OF QUALIFICATIONS**

I have frequently been called upon to develop and coordinate economic and operational studies relative to the rail transportation of various commodities. My responsibilities in these undertakings included the analyses of rail routes, rail operations and an assessment of the relative efficiency and costs of railroad operations over those routes. I have also analyzed and made recommendations regarding the acquisition of railcars according to the specific needs of various shippers. The results of these analyses have been employed in order to assist shippers in the development and negotiation of rail transportation contracts which optimize operational efficiency and cost effectiveness.

I have developed property and business valuations of privately held freight and passenger railroads for use in regulatory, litigation and commercial settings. These valuation assignments required me to develop company and/or industry specific costs of debt, preferred equity and common equity, as well as target and actual capital structures. I am also well acquainted with and have used the commonly accepted models for determining a company's cost of common equity, including the Discounted Cash Flow Model ("DCF"), Capital Asset Pricing Model ("CAPM"), and the Farma-French Three Factor Model.

Moreover, I have developed numerous variable cost calculations utilizing the various formulas employed by the Interstate Commerce Commission ("ICC") and the Surface Transportation Board ("STB") for the development of variable costs for common carriers.

**STATEMENT OF QUALIFICATIONS**

with particular emphasis on the basis and use of the Uniform Railroad Costing System ("URCS") and its predecessor, Rail Form A. I have utilized URCS/Rail form A costing principles since the beginning of my career with L. E. Peabody & Associates Inc. in 1971.

I have frequently presented both oral and written testimony before the ICC, STB, Federal Energy Regulatory Commission, Railroad Accounting Principles Board, Postal Rate Commission and numerous state regulatory commissions, federal courts and state courts. This testimony was generally related to the development of variable cost of service calculations, rail traffic and operating patterns, fuel supply economics, contract interpretations, economic principles concerning the maximum level of rates, implementation of maximum rate principles, and calculation of reparations or damages, including interest. I presented testimony before the Congress of the United States Committee on Transportation and Infrastructure on the status of rail competition in the western United States. I have also presented expert testimony in a number of court and arbitration proceedings concerning the level of rates, rate adjustment procedures, service, capacity, costing, rail operating procedures and other economic components of specific contracts.

Since the implementation of the Staggers Rail Act of 1980, which clarified that rail carriers could enter into transportation contracts with shippers, I have been actively

**STATEMENT OF QUALIFICATIONS**

involved in negotiating transportation contracts on behalf of shippers. Specifically, I have advised shippers concerning transportation rates based on market conditions and carrier competition, movement specific service commitments, specific cost-based rate adjustment provisions, contract reopeners that recognize changes in productivity and cost-based ancillary charges.

I have been actively engaged in negotiating coal supply contracts for various users throughout the United States. In addition, I have analyzed the economic impact of buying out, brokering, and modifying existing coal supply agreements. My coal supply assignments have encompassed analyzing alternative coals to determine the impact on the delivered price of operating and maintenance costs, unloading costs, shrinkage factor and by-product savings.

I have developed different economic analyses regarding rail transportation matters for over sixty (60) electric utility companies located in all parts of the United States, and for major associations, including American Paper Institute, American Petroleum Institute, Chemical Manufacturers Association, Coal Exporters Association, Edison Electric Institute, Mail Order Association of America, National Coal Association, National Industrial Transportation League, North America Freight Car Association, the Fertilizer Institute and Western Coal Traffic League. In addition, I have assisted numerous government agencies, major industries and major railroad companies in solving various transportation-related problems.

**STATEMENT OF QUALIFICATIONS**

In the two Western rail mergers that resulted in the creation of the present BNSF Railway Company and Union Pacific Railroad Company and in the acquisition of Conrail by Norfolk Southern Railway Company and CSX Transportation, Inc., I reviewed the railroads' applications including their supporting traffic, cost and operating data and provided detailed evidence supporting requests for conditions designed to maintain the competitive rail environment that existed before the proposed mergers and acquisition. In these proceedings, I represented shipper interests, including plastic, chemical, coal, paper and steel shippers.

I have participated in various proceedings involved with the division of through rail rates. For example, I participated in ICC Docket No. 35585, Akron, Canton & Youngstown Railroad Company, et al. v. Aberdeen and Rockfish Railroad Company, et al., which was a complaint filed by the northern and mid-western rail lines to change the primary north-south divisions. I was personally involved in all traffic, operating and cost aspects of this proceeding on behalf of the northern and mid-western rail lines. I was the lead witness on behalf of the Long Island Rail Road in ICC Docket No. 36874, Notice of Intent to File Division Complaint by the Long Island Rail Road Company.

**STATEMENT OF QUALIFICATIONS**

My name is Daniel L. Fapp. I am Vice President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, VA 22314; 760 E. Pusch View Lane, Suite 150, Tucson, Arizona 85737; and 21 Founders Way, Queensbury, New York 85737.

I received a Bachelor of Science degree in Business Administration with an option in Marketing (cum laude) from the California State University, Northridge in 1987, and a Master of Business Administration degree from the University of Arizona's Eller College of Management in 1993, specializing in finance and operations management. I am also a member of Beta Gamma Sigma, the national honor society for collegiate schools of business.

I have been employed by L. E. Peabody & Associates, Inc. since December 1997. Prior to joining L. E. Peabody & Associates, Inc., I was employed by BHP Copper Inc. in the role of Transportation Manager - Finance and Administration, and where I also served as an officer and treasurer of the three BHP Copper Inc. subsidiary railroads. The San Manuel Arizona Railroad, the Magma Arizona Railroad (also known as the BHP Arizona Railroad) and the BHP Nevada Railroad. I have also held operations management positions with Arizona Lithographers in Tucson, AZ and MCA-Universal Studios in Universal City, CA.

While at BHP Copper Inc., I was responsible for all financial and administrative functions of the company's transportation group. I also directed the BHP Copper Inc. subsidiary railroads' cost and revenue accounting staff, and managed the San Manuel Arizona Railroad's and BHP Arizona Railroad's dispatchers and the railroad dispatching functions. I served on the company's Commercial and Transportation Management Team and the company's Railroad Acquisition Team where I was responsible for evaluating the acquisition of new railroads,



**STATEMENT OF QUALIFICATIONS**

including developing financial and economic assessment models. While with MCA-Universal Studios, I held several operations management positions, including Tour Operations Manager, where my duties included vehicle routing and scheduling, personnel scheduling, forecasting facilities utilization, and designing and performing queuing analyses.

As part of my work for L. E. Peabody & Associates, Inc., I have performed and directed numerous projects and analyses undertaken on behalf of utility companies, short line railroads, bulk shippers, and industry and trade associations. Examples of studies which I have participated in organizing and directing include, traffic, operational and cost analyses in connection with the rail movement of coal, metallic ores, pulp and paper products, and other commodities. I have also analyzed multiple car movements, unit train operations, divisions of through rail rates and switching operations throughout the United States. The nature of these studies enabled me to become familiar with the operating procedures utilized by railroads in the normal course of business.

Since 1997, I have participated in the development of cost of service analyses for the movement of coal over the major eastern and western coal-hauling railroads. I have conducted on-site studies of switching, detention and line-haul activities relating to the handling of coal. I have also participated in and managed several projects assisting short-line railroads. In these engagements, I assisted short-line railroads in their negotiations with connecting Class I carriers, performed railroad property and business evaluations, and worked on rail line abandonment projects.

I have been frequently called upon to perform financial analyses and assessments of Class I, Class II and Class III railroad companies. I have determined the Going Concern Value

**STATEMENT OF QUALIFICATIONS**

of privately held freight and passenger railroads, including developing company specific costs of debt and equity for use in discounting future company cash flows. My consulting assignments regularly involve working with and determining various facets of railroad financial issues, including cost of capital determinations. In these assignments, I have calculated railroad capital structures, market values, cost of railroad debt, cost of preferred railroad equity and common railroad equity. I am also well acquainted with and have used financial industry accepted models for determining a firm's cost of equity, including Discounted Cash Flow Model ("DCF") models, Capital Asset Pricing Model ("CAPM"), Farma-French Three Factor Model and Arbitrage Pricing Models. Based on these assignments, I have frequently spoken and provided guest lectures on developing divisional, corporate and industry costs of equity to undergraduate and graduate level classes.

In my tenure with L. E. Peabody & Associates, Inc., I have presented stand-alone cost evidence in numerous proceedings before the STB, and presented evidence in several STB Ex Parte proceedings, including proceedings addressing railroad fuel surcharges and railroad industry cost of capital. In addition, my reports on railroad valuations have been used as evidence before the Nevada State Tax Commission.

**Estimated Number of BNSF Shipments That Will Move Below The Jurisdictional Threshold**

<u>Item</u> (1)	<u>Source</u> (2)	<u>Statistic</u> (3)
1. 2010 BNSF Carloads/Intermodal Units	BNSF Weekly Units Report for 1/1/11	9,143,043
2. Percentage of 2008 Carload Waybill Sample Tons With R/VC Between 180 and 300 Percent	1/	23%
3. Number of BNSF Carloads affected by R/VC between 180 and 300 Percent	Line 1 x Line 2	2,102,900
4. Percentage Increments Between 300 and 180 Percent	Subtract 300 from 180	120
5. Carloads for each percentage point based on equal distribution	Line 2 ÷ Line 4	17,524
6. Estimated Percentage Decline In Variable Costs at the Jurisdictional Threshold Level Due to Berkshire Acquisition Premium	2/	4.0%
7. Percentage Points Impacted by Increased Variable Costs	3/	<u>7</u>
8. BNSF Carloads affected by Berkshire Premium	Line 5 x Line 7	<b>122,669</b>

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- 1/ "An Update To The Study Of Competition In The U.S. Freight Railroad Industry -- Final Report," Lauritis R. Christensen Associates, Inc., January 2010, page 5-19.  
2/ Approximated based on change in costs for hypothetical movements.  
3/ 180% increased by ratio of 1.04 equals 187%, or an increase of 7 percentage points.

**Summary Of Variable Cost and Jurisdictional  
Threshold Rates For Sample Movements  
(1,000 Mile Coal Move)**

<u>Item</u> (1)	<u>As Reported</u> (2)	<u>Adjusted to Exclude Acquisition Premium</u> (3)	<u>Adjusted to Exclude Acquisition Premium Including Impact On 2010 COC</u> (4)
<b><u>Movement Parameters</u></b>			
1. Railroad	BNSF	BNSF	BNSF
2. Miles	1,000	1,000	1,000
3. Shipment Type	Local	Local	Local
4. Cars per Train	110	110	110
5. Car Type	Gen. Svc. Gondola	Gen. Svc. Gondola	Gen. Svc. Gondola
6. Car Ownership	Private	Private	Private
7. Tons per Car	120	120	120
8. STCC - Commodity	Coal	Coal	Coal
9. Movement Type	Unit Train	Unit Train	Unit Train
<b><u>Variable Costs</u></b>			
10. Phase III Cost Base Year 2010 <u>1/</u>	\$11.78	\$11.40	\$11.23
11. Index to 3Q 2011 <u>2/</u>	1.097	1.105	1.107
12. Phase III Costs 3Q 2011 <u>3/</u>	\$12.92	\$12.60	\$12.43
13. Jurisdictional Threshold <u>4/</u>	\$23.26	\$22.68	\$22.37
14. Impact of Premium	---	\$0.58 <u>5/</u>	\$0.88 <u>6/</u>

1/ 2010 BNSF URCS Phase III costs unadjusted and adjusted for the impacts of the BNSF acquisition.

2/ STB URCS Index unadjusted and adjusted for the impacts of the BNSF acquisition.

3/ Line 10 x Line 11.

4/ Line 12 x 180%.

5/ Column (2), Line 13 - Column (3), Line 13.

6/ Column (2), Line 13 - Column (4), Line 13.

**Summary Of Variable Cost and Jurisdictional  
Threshold Rates For Sample Movements**

**(1,200 Mile Grain Move)**

<u>Item</u> (1)	<u>As Reported</u> (2)	<u>Adjusted to Exclude Acquisition Premium</u> (3)	<u>Adjusted to Exclude Acquisition Premium Including Impact On 2010 COC</u> (4)
<b><u>Movement Parameters</u></b>			
1. Railroad	BNSF	BNSF	BNSF
2. Miles	1,200	1,200	1,200
3. Shipment Type	Local	Local	Local
4. Cars per Train	100	100	100
5. Car Type	Covered Hopper	Covered Hopper	Covered Hopper
6. Car Ownership	Railroad	Railroad	Railroad
7. Tons per Car	105	105	105
8. STCC - Commodity	Grain	Grain	Grain
9. Movement Type	Unit Train	Unit Train	Unit Train
<b><u>Variable Costs</u></b>			
10. Phase III Cost Base Year 2010 <u>1/</u>	\$17.90	\$17.58	\$17.31
11. Index to 3Q 2011 <u>2/</u>	1.097	1.105	1.107
12. Phase III Costs 3Q 2011 <u>3/</u>	\$19.65	\$19.43	\$19.16
13. Jurisdictional Threshold <u>4/</u>	\$35.37	\$34.97	\$34.49
14. Impact of Premium	---	\$0.40 <u>5/</u>	\$0.88 <u>6/</u>

1/ 2010 BNSF URCS Phase III costs unadjusted and adjusted for the impacts of the BNSF acquisition.

2/ SIB URCS Index unadjusted and adjusted for the impacts of the BNSF acquisition

3/ Line 10 x Line 11

4/ Line 12 x 180%.

5/ Column (2), Line 13 - Column (3), Line 13.

6/ Column (2), Line 13 - Column (4), Line 13.

**Development of WFA/Basin Rates Per Ton  
Based on STB Procedures and BNSF 2010 URCS -- 4Q11**

<b>Based On BNSF 2010 URCS</b>					
<b>Origin</b> <b>(1)</b>	<b>3Q11 Tons</b> <b>(2)</b>	<b>As Reported</b> <b>1/ (3)</b>	<b>Adjusted to Exclude Acquisition Premium</b> <b>2/ (4)</b>	<b>Adjusted to Exclude Acquisition Premium Including Impact On 2010 COC</b> <b>3/ (5)</b>	
1. Antelope	447,194	\$4.85	\$4.61	\$4.55	
2. Black Thunder	82,532	\$5.59	\$5.34	\$5.27	
3. Buckskin	196,622	\$7.21	\$6.92	\$6.83	
4. Caballo	244,002	\$6.37	\$6.09	\$6.01	
5. Dry Fork	627,723	\$7.01	\$6.72	\$6.63	
6. North Antelope	115,109	\$5.07	\$4.82	\$4.76	
7. Thunder West	16,541	\$5.77	\$5.51	\$5.43	
8. Total / Weighted Average	1,729,723	\$6.18	\$5.90	\$5.83	

1/ Variable costs based on BNSF 2010 URCS with STB 2010 pre-tax cost of capital of 16.39%. Variable costs are multiplied by the STB prescribed ratio of 2.46 to calculate WFA/Basin rates in 2011.

2/ Variable costs based on BNSF 2010 URCS excluding acquisition premium and using STB 2010 pre-tax cost of capital of 16.39%. Variable costs are multiplied by the STB prescribed ratio of 2.46 to calculate WFA/Basin rates in 2011.

3/ Variable costs based on BNSF 2010 URCS excluding acquisition premium and using STB 2010 pre-tax cost of capital adjusted to include BNSF in the cost of equity. STB's 2010 revised cost of capital equals 15.15%. Variable costs are multiplied by the STB prescribed ratio of 2.46 to calculate WFA/Basin rates in 2011.